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## TRANSCRIPT OF RECORD

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1938

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No. 328

GUY T. HELVERING, COMMISSIONER OF INTERNAL  
REVENUE, PETITIONER

vs.

R. J. REYNOLDS TOBACCO COMPANY

---

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT  
OF APPEALS FOR THE FOURTH CIRCUIT

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PETITION FOR CERTIORARI FILED SEPTEMBER 6, 1938

CERTIORARI GRANTED OCTOBER 17, 1938

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# SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1938

No. 328

GUY T. HELVERING, COMMISSIONER OF INTERNAL  
REVENUE, PETITIONER

VS.

R. J. REYNOLDS TOBACCO COMPANY

WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT  
OF APPEALS FOR THE FOURTH CIRCUIT

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BEFORE UNITED STATES BOARD OF TAX APPEALS

R. J. REYNOLDS TOBACCO COMPANY, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances: For Taxpayer: D. H. Blair, Esq., M. A. Braswell, Esq., J. G. Korner, Jr., Esq. For Comm'r: Arthur H. Fast, Esq., E. C. Adams, Esq., B. M. Brodsky, Esq.

*Docket entries*

1933

- May 4—Petition received and filed. Taxpayer notified. Fee paid.
- May 5—Copy of petition served on General Counsel.
- June 27—Answer filed by General Counsel.
- July 6—Copy of answer served on taxpayer.

1935

- Sept. 9—Hearing set Oct. 30, 1935.
- Sept. 18—Motion for continuance to a day not earlier than Dec. 1, 1935, filed by taxpayer.
- Sept. 19—Motion for continuance granted and continued to January 13, 1936.

1936

- Jan. 4—Motion for a continuance to a date not earlier than February 24, 1936, filed by taxpayer.
- Jan. 6—Motion for continuance to a date not earlier than Feb. 24, 1936, granted and continued to Feb. 24, 1936.
- Feb. 12—Motion for continuance to March 16, 1936, filed by General Counsel. 2/12/36. Granted.
- Feb. 13—Motion for leave to file amended answer, amendment lodged, filed by General Counsel. 2/15/36. Granted.
- Mar. 7—Motion for continuance to 4/26/36 filed by taxpayer. Granted.
- Mar. 14—Reply to amended answer filed by taxpayer. 3/16/36 copy served on General Counsel.
- Apr. 18—Application for subpoena to James A. Gray and S. Clay Williams filed by General Counsel.
- 2 Apr. 18—Subpoena to James A. Gray issued.
- Apr. 18—Subpoena to S. Clay Williams issued.
- Apr. 27—Hearing had before Mr. Van Fossan on merits. Submitted. Petitioners and respondent's motions filed. Stipulation of facts filed. Subpoena to S. Clay Williams filed. Respondent's brief due 5/27/36. Petitioner's reply June 27, 1936, Respondent reply July 13, 1936.
- Apr. 27—Petitioner's motion for order granting petitioner the opportunity to present and claim proper deductions at the settlement of final deficiency under Rule 50—Granted.

1936

- Apr. 28—Transcript of hearing of April 27, 1936, filed.
- May 6—Motion to correct transcript of record of the hearing on April 27, 1936, filed.
- May 6—Motion to correct transcript of record of the hearing on April 27, 1936, granted.
- May 23—Brief filed by General Counsel.
- May 23—Respondent's rejoinder to petitioner's reply to amended answer of respondent, filed.
- June 5—Brief filed by taxpayer. 10/5/36 copy served on General Counsel.

1937

- Feb. 19—Motion for additional authority supporting petitioner's contentions filed by taxpayer. 2/19/37 copy served on General Counsel.
- Apr. 27—Findings of fact and opinion rendered, E. H. Van Fossan, Div. 9. Decision will be entered under Rule 50.
- June 17—Notice of settlement filed by General Counsel.
- June 19—Hearing set July 14, 1937, on settlement under Rule 50.
- July 14—Hearing had before Mr. Miller, Div. 16, on settlement under Rule 50. Not contested—Referred to Mr. Van Fossan, Div. 9, for decision.
- July 16—Decision entered—Eugene Black, Div. 15.
- Oct. 12—Petition for review by United States Circuit Court of Appeals, 4th Circuit, with assignments of error filed by taxpayer.
- 3 Oct. 12—Proof of service filed.
- Dec. 2—Agreed statement of evidence approved and ordered filed.
- Dec. 2—Agreed *praecipe* with proof of service thereon filed.

Before United States Board of Tax Appeals

[Title omitted.]

*Petition*

Filed May 4, 1933

Comes now the petitioner and appeals from the determination by the Commissioner of an alleged deficiency, as set forth in his deficiency notice dated April 3, 1933 (IT:AR:C-4:HLL-60D), and prays the Board to review and redetermine the tax liability of the petitioner in accordance with law. The petitioner alleges:

# I

Petitioner is a New Jersey corporation with its principal office and place of business in Winston-Salem, North Carolina, which is in the Collection District of North Carolina.

## II

The notice of deficiency (copy of which is hereto attached and marked Exhibit A) was mailed to the petitioner on April 3, 1933.

## III

The tax in controversy is income tax for the calendar year 1929 and is in the amount of \$15,990.65.

## IV

The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) The Commissioner erroneously added to petitioner's net income \$145,369.52 (being \$145,475.44 less a minor adjustment of \$105.92) alleging the same to be a profit realized in a liquidation or a liquidating dividend, when the transaction in question constituted a reorganization (giving rise to no gain), wherein under the plan of reorganization the petitioner acquired all the assets of another corporation.

(b) The Commissioner, in computing the alleged profit, alleged by himself to have been realized by petitioner as aforesaid, erroneously assumed \$100,719.92 to have been the cost of the stock which he alleges was exchanged for the assets in question; whereas the cost of the said stock was \$174,998.32.

## V

Petitioner alleges the following facts:

(a) Petitioner is, and was during the taxable years 1927, 1928, and 1929, a New Jersey corporation, with its principal office and place of business in Winston-Salem, North Carolina, and is engaged in the manufacture of cigarettes and other tobacco products. In its business as aforesaid the petitioner uses a large amount of foil for wrapping its products.

(b) In 1927 there was situate at Richmond, Virginia, a Virginia corporation, the Tobacco Foil Company, which manufactured foil used by petitioner and was the chief source of supply of the foil so used by petitioner.

(c) Tobacco Foil Company owned a plant in Richmond, Virginia, in which it manufactured its product. This plant was equipped with the machinery and other equipment designed for and used in the manufacture of its foil product, which was of a high grade and quality.

(d) Petitioner desired to manufacture its own foil and in order to accomplish this result it sought to purchase the assets of Tobacco Foil Company and to remove such assets to Winston-Salem, North Carolina, and there to install those assets (exclusive of real estate) in petitioner's plant in Winston-Salem, and to manufacture for its own use the foil then being manufactured by Tobacco Foil Company.

(e) Substantially all of the capital stock of Tobacco Foil Company was owned by S. Q. Kline, R. B. Campbell, and W. E. Gaines, who constituted the officers and board of directors of that company. Petitioner entered into negotiations with the said officers and directors, the plan being the purchase of the assets of the Tobacco Foil Company and the employment by petitioner of Messrs. Kline, Campbell, and Gaines to operate the said assets after their removal to petitioner's plant in Winston-Salem, N. C. Accordingly petitioner made a proposal to the directors of Tobacco Foil Company in accordance with the said plan.

(f) As the negotiations proceeded the plan of the petitioner was effected in the following manner: On June 3, 1927, a contract was executed between the petitioner and Messrs. Kline, Campbell, and Gaines by the terms of which petitioner acquired from said Kline, Campbell, and Gaines all the capital stock of Tobacco Foil Company for the sum of \$174,998.32 in cash. The contract further provided that Messrs. Kline, Campbell, and Gaines would dismantle the plant in Richmond, Virginia, and remove all the assets of Tobacco Foil Company (except the real estate in Richmond, Va.), to Winston-Salem, N. C., and install such assets in the plant of petitioner in said city; that said Kline, Campbell, and Gaines would install the said assets in petitioner's plant in Winston-Salem, N. C., and supervise the operation thereof and instruct the employees of petitioner in said operation for a period of not less than six months after completion of said installation and commencement of operation of the assets in petitioner's plant; that said Kline, Campbell, and Gaines would be paid salaries for such services from and after July 1, 1927.

(g) The plan of the petitioner was to secure the assets of Tobacco Foil Company and install them in its own plant in Winston-Salem, N. C.; to secure the services of Messrs. Kline, Campbell, and Gaines in installing and instructing petitioner's employees in the operation of the said assets; to dissolve the Tobacco Foil Company when this had been accomplished.

(h) Thereafter, and in accordance with the plan above outlined, and pursuant to the intent and purpose of said plan, the plant of Tobacco Foil Company at Richmond, Va., was dismantled and the machinery and equipment removed therefrom to the plant of the petitioner at Winston-Salem, N. C., under the supervision and direction of Messrs. Kline, Campbell, and Gaines, who continued their employment in installing and setting up the said assets for operation in petitioner's plant and thereafter instructed the employees of petitioner in the operation thereof.

(i) Thereupon, in April 1929 the petitioner caused the taking over of the assets which had theretofore been accomplished, as aforesaid, to be ratified by formal documents of conveyance and thereupon caused the Tobacco Foil Company to be dissolved.

(j) The matters and things done as aforesaid all constituted a part and parcel of one plant whereby petitioner acquired all of the assets of Tobacco Foil Company, and each step taken to that end

was a step in the said plan and pursuant thereto, and constituted a statutory reorganization.

(k) The petitioner realized no gain in the said transaction and no gain is recognized on the transaction under the statute.

And, as another and further defense to the proposed deficiency asserted by the Commissioner, the petitioner alleges:

(l) The cost of all the stock of Tobacco Foil Company, acquired by petitioner as above herein set out, was \$174,998.32 in cash.

(m) The assets taken over by petitioner from Tobacco Foil Company had a net worth in an amount not greater than \$246,195.36.

(n) The Commissioner has proposed to increase the net income of petitioner on account of the foregoing transaction, in the amount of \$145,475.44 (less an uncontested adjustment for depreciation of \$105.92), or in the net amount of \$145,369.51, and on said last amount has computed (at 11% rate) a proposed deficiency in tax of \$15,990.65.

(o) The action of the Commissioner is erroneous and without warrant or justification in law.

Wherefore the petitioner prays that the Board may hear this cause and determine and decide that there is no deficiency due from the petitioner on account of income taxes for the year 1929.

(s) D. H. BLAIR,

(s) M. A. BRASWELL,

(s) J. G. KOINER, Jr.,

*Transportation Bldg., Washington, D. C.*

*[Duly sworn to by S. Clay Williams; jurat omitted in printing.]*

Exhibit "A" to petition

TREASURY DEPARTMENT,

*Washington, Apr. 3, 1933.*

IT:AR:C-4

HLL-60D

R. J. REYNOLDS TOBACCO COMPANY,

*Main and Fourth Streets,*

*Winston-Salem, North Carolina.*

SIRS: You are advised that the determination of your tax liability for the year(s) 1929 discloses a deficiency of \$15,990.65, as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

However, if you do not desire to petition, you are requested to execute the inclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this form will expedite the closing of your return(s) by permitting an early assessment of any deficiency and preventing the

6 GUY T. HELVERING VS. R. J. REYNOLDS TOBACCO CO.

accumulation of interest charges, since the interest period terminates thirty days after filing the inclosed form, or on the date assessment is made, whichever is earlier; whereas if this form is not filed, interest will accumulate to the date of the assessment of the deficiency.

Respectfully,

DAVID BURNETT,  
Commissioner.

By (Signed) W. T. SHERWOOD,  
Acting Deputy Commissioner.

Inclosures:  
Statement  
Form 870. IJ-1.

9

STATEMENT

IT: AR: C-4  
HLL-60D

In re: R. J. Reynolds Tobacco Company, Main and Fourth Streets,  
Winston-Salem, North Carolina.

INCOME TAX LIABILITY

Year	Income Tax Liability	Income Tax Assessed	Deficiency
1929	\$4, 234, 676. 17	\$4, 218, 685. 52	\$15, 990. 65

The report of the internal revenue agent in charge, Greensboro, North Carolina, a copy of which was furnished you, is approved and is hereby made a part of this letter.

Careful consideration has been accorded your protests dated February 2, 1932, and April 30, 1932, and the information submitted at the conference held in this office on February 17, 1932, and July 8, 1932. It is held by this office that a profit of \$145,475.44 resulted from the purchase and subsequent liquidation of the Tobacco Foil Products Company.

A copy of this communication has been furnished your representative, Mr. Jules G. Koiner, Jr., Transportation Building, Washington, D. C., who has on file in this office a duly recorded power of attorney.

Consents which will expire June 30, 1934, are on file for the year 1929.

IJ-1

Before United States Board of Tax Appeals  
[Title omitted.]

Answer

Filed June 27, 1933

10 Comes now the respondent by his attorney, E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue, and in answer to the petition of the petitioner, admits, denies and alleges as follows:

I, II, and III. Admits the allegations contained in paragraphs one, two, and three of the petition.

IV. (a) and (b) Denies that the respondent committed errors as alleged in paragraph four (a) and (b) of the petition.

V. (a), (b), and (c) Admits the allegations contained in sub-paragraphs (a), (b), and (c) of paragraph five of the petition.

V. (d), (e), (f), (g), (h), and (i) Denies each and every allegation contained in sub-paragraph (d), (e), (f), (g), (h), and (i) of paragraph five of the petition, which is contrary to or inconsistent with the determination of the Commissioner as set forth in the notice of deficiency.

V. (j), (k), (l), and (m) Denies the allegations contained in sub-paragraphs (j), (k), (l), and (m) of paragraph five of the petition.

V. (n) Admits the allegations contained in paragraph five (n) of the petition.

V. (o) Denies the allegations contained in paragraph five (o) of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified, or denied.

Wherefore, it is prayed that the petitioner's appeal be denied and the Commissioner's determination of deficiency be approved.

(Signed) E. BARRETT PRETTYMAN,  
General Counsel,  
Bureau of Internal Revenue.

Of Counsel:

DEWITT M. EVANS,  
Special Attorney,  
Bureau of Internal Revenue.

11 Before United States Board of Tax Appeals

[Title omitted.]

*Amended answer*

Lodged February 13, 1936

Filed Feb. 15, 1936

Comes now the Commissioner of Internal Revenue, by his attorney, Herman Oliphant, General Counsel for the Department of the Treasury, and for amended answer to the petition filed herein admits, denies, and alleges as follows:

I. Admits the allegations contained in paragraph I of the petition.

II. Admits the allegations contained in paragraph II of the petition.

III. Admits that the tax in controversy is income tax for the calendar year 1929, but denies that the amount in controversy is \$15,990.65.

IV. Denies that the respondent committed the errors as alleged in paragraph IV of the petition.

V-(a), (b), and (c). Admits the allegations contained in paragraphs V-(a), (b), and (c) of the petition.

(d) to (m), inclusive. Denies the allegations contained in paragraphs V (d) to (m), inclusive, of the petition.

12 (n) Admits the allegations contained in paragraph V (n) of the petition.

(o) Denies the allegations contained in paragraph V (o) of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore specifically admitted, qualified, or denied.

VI. The respondent desires to raise an affirmative issue after indicated. With respect to such affirmative issue, the alleges as follows:

(a) That during the year 1921 the petitioner, the R. J. Reynolds Tobacco Company, began trafficking (that is, buying and selling) in Class B common stock of the R. J. Reynolds Tobacco Company, i. e., its own stock. This trafficking in a considerable volume continued throughout the years 1921 to 1933, inclusive.

(b) That during the year 1929 the R. J. Reynolds Tobacco Company, through the Equitable Trust Company, New York, New York, sold in the open market 15,000 shares Class B common stock of the R. J. Reynolds Tobacco Company for a net sales price of \$708,690.00, which shares had been acquired subsequent to January 1, 1921, by the said R. J. Reynolds Tobacco Company through its so-called nominee account entitled Robert S. Campbell. The net cost of these 15,000 shares of Class B common stock of the R. J. Reynolds Tobacco Company to the said R. J. Reynolds Tobacco Company was \$121,440.19. The taxable profit realized by the said R. J. Reynolds Tobacco Company from trafficking in these shares was \$587,249.81.

(c) That during the year 1929 the R. J. Reynolds Tobacco Company, through the Equitable Trust Company, New York, New York, and various brokers, sold in the open market 94,500 shares of Class B common stock of the said R. J. Reynolds Tobacco Company for a net sales price of \$4,506,497.00, which shares had been acquired subsequent to January 1, 1929, by the said R. J. Reynolds Tobacco Company through its so-called nominee account entitled Edward C. Kenny. The net cost of these 94,500 shares of Class B common stock of the said R. J. Reynolds Tobacco Company to the said R. J. Reynolds Tobacco Company was \$4,908,966.17. The loss realized by the said R. J. Reynolds Tobacco Company from trafficking in these shares was \$402,469.17. The deductibility of this loss is conceded only if the affirmative issues raised herein be sustained.

(d) That during the year 1929 the R. J. Reynolds Tobacco Company through the Equitable Trust Company, New York, New York, and various brokers, sold in the open market 99,500 shares of Class B common stock of the said R. J. Reynolds Tobacco Company for a net sales price of \$4,703,608.00, which shares had been acquired subsequent to January 1, 1929, by the said R. J. Reynolds Tobacco Company through its so-called nominee account entitled Horace E. Whitney. The net cost of these 99,500 shares of Class B common

stock of the R. J. Reynolds Tobacco Company to the R. J. Reynolds Tobacco Company was \$4,601,807.43. The taxable profit realized by the said R. J. Reynolds Tobacco Company through trafficking in these shares was \$101,800.57.

(e) That neither the purchases and sales or any of them of the Class B common stock of the R. J. Reynolds Tobacco Company by the said R. J. Reynolds Tobacco Company (as alleged above) were made in connection with any transaction whereby the total outstanding stock and/or bonds of the said R. J. Reynolds Tobacco Company was increased or diminished; furthermore that neither such purchases and sales or any of them was made in connection with any transaction whereby any of the said Class B common stock was retired or cancelled or any of the assets of the said R. J. Reynolds Tobacco Company was liquidated. In short the shares of stock above mentioned were not acquired or parted with in connection with a readjustment of the capital structure of the R. J. Reynolds Tobacco Company; that the purchases and sales were recorded in the investment account of the petitioner and were reflected in its profit and loss account and  
14 in its surplus account; and that none of these purchases and sales during 1929 was reflected in the capital stock account of the R. J. Reynolds Tobacco Company.

(f) That the net taxable profit realized during the year 1929 by the R. J. Reynolds Tobacco Company through trafficking in Class B common stock of the R. J. Reynolds Tobacco Company (as indicated in paragraphs (b), (c), and (d) supra, was \$286,581.21.

(g) That a net income for 1929 of \$38,497,056.05 formed the basis of the notice of deficiency dated April 3, 1933, from which this appeal was taken. Such net income should be increased by the sum of \$286,581.21 representing the taxable profit realized by the R. J. Reynolds Tobacco Company through trafficking in Class B common stock of the R. J. Reynolds Tobacco Company.

Wherefore, it is prayed that the net income of the R. J. Reynolds Tobacco Company for the year ended December 31, 1929, as shown in the notice of deficiency dated April 3, 1933, of \$38,497,056.05, be increased by the sum of \$286,581.21, representing the net profit realized by the R. J. Reynolds Tobacco Company through trafficking in Class B common stock of the R. J. Reynolds Tobacco Company; and that the tax, as shown in said notice of deficiency dated April 3, 1933, be ordered recomputed and that the deficiency of \$15,990.65 as shown in said notice be increased accordingly. Claim for said increased deficiency is hereby made under the provisions of Section 272 (e) of the Revenue Act of 1928.

(Signed) HERMAN OLIPHANT,

*General Counsel for the Department of the Treasury.*

Of Counsel:

A. H. FAST,

PAUL E. WARING,

*Special Attorneys.*

*Bureau of Internal Revenue.*

AHF-PEW-fw-1-18-36.

[Title omitted.]

*Petitioner's reply to amended answer of respondent*

Filed March 14, 1936

Comes now the petitioner, and for reply to the Amended Answer of Respondent, filed in this cause, admits, denies, and alleges as follows:

VI. (a) Denies the allegations as set forth in paragraph VI (a) of the Amended Answer, except that it is admitted that in the year 1921, the petitioner acquired for cash certain certificates representing shares of Class B Common Stock of the R. J. Reynolds Tobacco Company.

(b) Denies the allegations as set forth in paragraph VI (b) of Respondent's Amended Answer, except that it is admitted that during the year 1929, the petitioner cancelled certificates held by it representing 15,000 shares of Class B Common Stock of R. J. Reynolds Tobacco Company which it had acquired for cash in the year 1921, as aforesaid, and issued in lieu thereof new certificates representing 15,000 shares of the said stock to divers persons who paid into the treasury of the petitioner in the year 1929, the sum of \$708,690.00, in cash, in consideration for the issuance to them of the said new certificates representing 15,000 shares of the said Class B Common Stock of R. J. Reynolds Tobacco Company; and it is further admitted that the acquisition by the petitioner of the said certificates representing the said 15,000 shares of Class B Common Stock, which occurred in the year 1921, was for cash in the amount of \$121,440.19.

16 (c) Denies the allegations as set forth in paragraph VI (c) of Respondent's Amended Answer, except that it is admitted that in the year 1929 the petitioner acquired for cash, in the amount of \$4,908,966.17, certificates representing 94,500 shares of Class B Common Stock of R. J. Reynolds Tobacco Company, and that later in the same year 1929, the petitioner cancelled the said certificates so acquired by it, as aforesaid, and issued in lieu thereof new certificates representing 94,500 shares of Class B Common Stock to divers persons who paid into the treasury of the petitioner in the year 1929, the sum of \$4,506,497.00 in cash, in consideration for the issuance to them of the said new certificates representing 94,500 shares of the said Class B Common Stock of R. J. Reynolds Tobacco Company.

(d) Denies the allegations as set forth in paragraph VI (d) of Respondent's Amended Answer, except that it is admitted that in the year 1929 the petitioner acquired for cash, in the amount of \$4,691,807.43, certificates representing 99,500 shares of Class B Common Stock of R. J. Reynolds Tobacco Company, and that later in the same year 1929 the petitioner cancelled the said certificates so acquired by it, as aforesaid, and issued in lieu thereof new certificates representing 99,500 shares of Class B Common Stock to divers persons who paid into the treasury of the petitioner in the year 1929 the sum of

\$4,703,608.00 in cash in consideration for the issuance to them of the said new certificates representing 99,500 shares of the said Class B Common Stock of R. J. Reynolds Tobacco Company.

(e) Denies the allegations as set out in paragraph VI (e) of Respondent's Amended Answer, except that it is admitted that from the time of the acquisition of the certificates representing shares of Class B Common Stock until the time of their cancellation and the issuance of new certificates in lieu thereof, as set out above in paragraphs VI (a), (b), (c), and (d) of this Reply, the said certificates were entered and recorded on the books and records of the petitioner, not as a current asset but in an account designated as "Investments in non-competitive companies," in which said account they were entered at the amounts of money for which they were so acquired; and it is further admitted

that the stock books and stock records of the petitioner in which were recorded the number of shares of its capital stock (Class B Common Stock) indicated that throughout the year 1929, the number of issued and outstanding shares of Class B Common Stock was at all times 9,000,000 shares.

(f) Denies the allegations contained in paragraph VI (f) of Respondent's Amended Answer.

(g) Denies the allegations as set forth in paragraph VI (g) of Respondent's Amended Answer, except that it is admitted that the Commissioner determined and asserted in his statutory deficiency notice of April 3, 1933 (the so-called 60-day letter), from which the instant appeal was taken, that the net income of petitioner for the year 1929 was \$38,497,056.05, and that on that basis the Commissioner computed the deficiency from which this petitioner appealed to the Board on May 4, 1933.

VII. Petitioner, for further reply and defense to the issue raised by the respondent in paragraph VI of his Amended Answer, alleges:

(a) Petitioner was not a trafficker or dealer in the stocks of any corporation and petitioner did not traffic or deal in its own stock or the stock of any other corporation, and did not so traffic or deal in its own stock in the year 1929.

(b) In the year 1921 and in the year 1929 the petitioner had acquired, and did acquire, for cash, certificates representing shares of Class B Common Stock of R. J. Reynolds Tobacco Company, which were later cancelled and new certificates issued in lieu thereof for cash, as hereinabove set out, and on each such occasion the transaction was for good and sufficient reasons which were connected with the protection and conservation of petitioner's business and of its capital structure, and was, on each such occasion, pursuant to sound business judgment connected with policy and policy matters of grave importance to the petitioner, which were entirely independent of, and were wholly distinct and separate from gain or loss, if any, which might result from such transaction: that such transactions were not a part of, and did not constitute a business operation of the petitioner, whose business is confined solely to the manufacture and sale of cigarettes, smoking tobacco, and other tobacco products, and its business and busi-

ness operations do not include or comprehend trafficking or dealing in stocks or securities.

(c) None of the transactions set out in paragraphs VI and VII of this Reply, and referred to by respondent in paragraph VI of his Amended Answer, were transactions in which petitioner acquired or disposed of an asset or bought and sold an asset, and in none of said transactions did petitioner acquire or dispose of an asset or buy and sell an asset; and in none of said transactions did petitioner realize a taxable profit and no tax arises by, upon, or out of any of the said transactions.

(d) All of the transactions occurring in the year 1929, which give rise to the issue raised by the respondent in paragraph VI of his Amended Answer, were made under and pursuant to the Revenue Act of 1928 and the Regulations duly promulgated under and pursuant to that said Act, and were made in light of the provisions of that said Act and of those said Regulations and of the opinions, rulings, decisions, judgments, and decrees of the Secretary of the Treasury, of the Commissioner of Internal Revenue, of the General Counsel of the Bureau of Internal Revenue, of the Board of Tax Appeals, and of various courts and tribunals, all of which specifically ruled and held that a corporation did not realize a taxable profit nor sustain a deductible loss solely upon the acquisition by it of shares of its own stock or upon the issuance or disposal by it to others of such shares of its own stock.

(e) The Revenue Act of 1928, as well as revenue acts prior thereto and revenue acts subsequent thereto, was enacted by the Congress in light of the long continued regulations, rulings, opinions, and decisions, as aforesaid, and in such enactments the Congress adopted, affirmed, and incorporated such rulings and decisions into the aim, purpose, and intentment of the Revenue Act of 1928, and petitioner alleges that such was the aim, purpose, intentment, and enactment of the Revenue Act of 1928, as is further evidenced by the Regula-

10 tions promulgated pursuant to and under the authority of the said Revenue Act of 1928, and of the next ensuing Revenue Act of 1932, and the Regulations promulgated pursuant thereto; and by its said repeated and long-standing enactments Congress aimed, purposed, intended, and enacted by the Revenue Act of 1928 that no gain should be realized and no loss should be sustained by a corporation upon its acquisition, for cash, and its reissuance, for cash, of shares of its own stock or of certificates representing shares of its own stock.

(f) The attempt of the Commissioner to assert and assess a tax upon profits alleged by him to have arisen by, upon, or out of such said transactions is an attempt to amend the Revenue Act of 1928 by administrative fiat and without legislative sanction, approval or enactment, and is an attempt to apply such an amendment, promulgated by himself with the approval of the Secretary on May 2, 1934, as Treasury Decision #4430, retroactively to the year 1929; and the petitioner further alleges that the Regulation under which the respondent now purports to act, as aforesaid, even though it were a valid Regulation and amendment to the statute, which petitioner

denies, does not impose, give rise to, or support a tax upon the transactions hereinabove set out, and that such said transactions are not made taxable by the provisions of such said purported or attempted amendment.

(g) The transactions which occurred in the year 1929, as hereinabove set out by the petitioner, were completed and closed transactions in the said year 1929; that, as petitioner is informed, advised and believes, in the year 1929 many thousands of taxpayers made similar transactions pursuant to and in the light of the Revenue Act of 1928, and the Regulations, rulings and decisions pertaining thereto, whose said transactions have not been questioned and upon which no tax has been asserted or attempted to be asserted; that, as petitioner is informed, advised and believes, the action of the respondent in his Amended Answer, in asserting a tax upon the predicate that it arose out of the transactions made by the petitioner in 1929, as hereinabove set out, is violative of law, and is violative of the fundamental principle of uniformity of taxation, and is violative of the provisions of the Constitution of the United States.

Wherefore, the petitioner prays that respondent's appeal, as set out in paragraph VI of his Amended Answer be denied; that the Board hear this cause and determine and decide that there is no deficiency due from the petitioner on account of income taxes for the year 1929.

M. A. BRASWELL,

D. H. BLAIR,

J. G. KORNER, Jr.,

404 Transportation Building, Washington, D. C.,  
Council for Petitioner.

Before United States Board of Tax Appeals

[Title omitted.]

*Respondent's rejoinder to petitioner's reply to amended answer*

Filed May 23, 1936

Comes now the Commissioner of Internal Revenue by his attorney, Herman Oliphant, General Counsel for the Department of the Treasury, and for rejoinder to petitioner's reply to amended answer of respondent, pleads as follows:

Respondent desires to stand on that portion of Rule 18 of the Board's Rules of Practice which states:

"Any new or affirmative matter contained in the reply is to be deemed to be denied,"

in all respects save only one. Said exception is as follows:

Respondent admits that the transactions which occurred in the year 1929 were completed and closed transactions in the said year 1929 as is alleged in paragraph VII (g) of petitioner's reply.

Respondent files the instant rejoinder in compliance with Rule 32 of Board's Rules of Practice, revised to July 1, 1935, inasmuch as the aforesaid admission was made orally during the trial of this cause on April 27, 1936 (R. 8 and 9), and is hereby reduced to writing as required by the aforesaid Rule 32.

(Signed) HERMAN OLIPHANT,

*General Counsel for the Department of the Treasury.*

Of Counsel:

A. H. FAST,

E. C. ADAMS,

*Special Attorneys,*

*Bureau of Internal Revenue.*

5-22-36.

Before United States Board of Tax Appeals

[Title omitted.]

*Findings of fact and opinion*

Promulgated April 27, 1937

Over a period of several years, in pursuance of its policy of broadening its stockholding base, protecting its stock and business, and to support the market, petitioner corporation bought shares of its own stock for cash on the open market and later sold certain of the shares so acquired. The stock was not retired but was held as treasury stock and carried in its investment account. During the taxable year 1929 petitioner so bought 574,000 shares. Also during the taxable year 1929 petitioner sold 194,000 shares of its own stock acquired during 1929, and 15,000 shares previously acquired. These sales were for cash on the open market, each transaction of purchase or sale being handled in the same manner as ordinary commercial transactions of purchase and sale. Held: Petitioner's transactions were taxable transactions from which gain or loss resulted. *Simmons & Hammond Manufacturing Co.*, 1 B. T. A. 803, overruled.

J. G. Korner, Jr., Esq., D. H. Blair, Esq., and M. A. Braswell, Esq., for the petitioner.

A. H. Fast, Esq., and E. C. Adams, Esq., for the respondent.

At its inception this proceeding involved a deficiency of \$15,990.65, income taxes for 1929. The parties, however, have disposed of this deficiency by stipulation as hereinafter set forth. A new deficiency of \$39,036.91 has been asserted by respondent in an amended answer based upon his determination that petitioner realized a taxable profit of \$286,581.21 from sales of its own new class B common stock during 1929. Petitioner's reply challenges the correctness of this latest determination of respondent.

The record consists of a written stipulation of facts with attached documents as a part thereof, oral testimony, and exhibits received in evidence at the hearing.

FINDINGS OF FACT

The petitioner is a corporation organized in 1899 under the laws of the State of New Jersey. Its principal office and place of business is Winston-Salem, North Carolina. It is engaged in the manufacture and sale of tobacco products, including plug, twist, smoking tobacco, and cigarettes.

From time to time since 1901 the capital structure of the corporation has been changed by increases in the common stock, by the issuance of new classes of common stock known as class B common, later eliminated in favor of new class B common, by the issuance and subsequent retirement of preferred stocks, by stock dividends, and by stock split-ups due to reduction in the par value of the common stock, all of which is more particularly set forth in the stipulation submitted by the parties hereto. During the taxable year 1929 the total capitalization of R. J. Reynolds Tobacco Co. was:

1,000,000 shares common stock at \$10 par value-----	\$10,000,000
9,000,000 shares new class B common stock at \$10 par value-----	90,000,000
10,000,000 shares outstanding capital stock-----	\$100,000,000

The principal difference between common stock and new class B common is that the latter had no voting power and was not considered under the company's plan providing for participation by officers and employees in certain profits of the company. There was no authorization during the taxable year by charter amendment whereby the authorized number, class, or par value of petitioner's shares of stock was increased or decreased.

In 1912 the petitioner was young in the tobacco industry, being a very small corporation whose stock was owned by one family until other stockholders were brought in from time to time. Its principal stockholder and founder was R. J. Reynolds, whose practice it was to bring as many employees as possible into the company as stockholders. Under the by-laws of the company, the holders of the only stock then outstanding were entitled to a special distribution each year based on the profits realized, and as a result the owners of this class of stock retained their holdings in order to participate in the profits.

At 1912 petitioner was in vigorous competition with three other tobacco companies, each having many times the capital of petitioner. After 1912 petitioner's growth was rapid. Its business prospered to such an extent that maintaining the capitalization of the company at a point where it could support the rapid expansion of the business, and meet competitive conditions, presented a serious problem. At the same time the management of the petitioner desired to preserve (1) the reputation of the company, (2) the reputation of the stock, and (3) the behavior of the stock on the market, including its behavior in comparison with other similar stocks.

In 1918 the petitioner created the class B common stock which did not participate in the special distribution based on

the company's profits, and which was, therefore, available on the open market. Later this class B stock was eliminated by charter amendment in April 1926.

In July 1918, R. J. Reynolds, petitioner's largest stockholder, died. It became necessary for his estate to sell a substantial portion of the stock in order to pay the inheritance taxes on his estate. The stockholders of the petitioner were not large enough to absorb the stock sold by the founder's estate. This stock was purchased by several individuals, but subsequently, and prior to 1921, it was finally concentrated in the single ownership of United Retail Stores, which controlled United Cigar Stores, a large distributor of petitioner's tobacco products. United Retail Stores publicized the fact that it owned a substantial block of petitioner's stock. Rumors developed and the suspicion grew that United Retail Stores was dictating petitioner's business policies and was able to buy petitioner's tobacco products at lower prices and for better discount than other distributors and retailers. Furthermore, the dividends regularly paid by the petitioner made it possible for United Retail Stores to operate its approximately 2,000 retail stores without profit, and yet have a substantial amount with which to pay dividends to its own stockholders.

It was the judgment of petitioner's management that the reputation of the company, and the necessity of protecting its business required the purchase of this United Retail Stores' stock. Petitioner had recognized in 1918 the necessity of broadening its stockholding base, and the acquisition of this block of stock afforded petitioner an opportunity to remove a harmful situation and at the same time permitted petitioner to expand its stockholding list by feeding the stock back onto the market. The law department of the petitioner considered and ruled that petitioner was authorized to make the 1921 purchase, and the other purchases hereinafter related, and reissue the stock, although petitioner had no charter authority to deal in its own stocks.

For the reasons aforementioned the petitioner purchased during 1921 the block of old class B common stock held by United Retail Stores, the number of shares purchased being undisclosed. The purchase was made at a private sale, the stock in question not being listed on any exchange in 1921. The consideration paid was \$607,200.96 in cash, which was slightly under the market price by reason of the amount of stock involved. As the result of subsequently effected stock split-ups and stock dividends, that portion of this purchase here involved came to represent 75,000 shares of new class B common stock, the certificates therefor being held by petitioner on January 31, 1929.

During all the years 1921 to 1929, inclusive, and thereafter, the petitioner followed the same general policy of availing itself of all opportunities that were presented for extending its stockholding base. The effectiveness of this general policy is revealed by the increase in the number of petitioner's stockholders over a period of years. In March 1922, when petitioner's stock was listed on the New York Stock

Exchange, petitioner had less than 2,000 stockholders, counting common stock and class B common stock. At the time of the market crash in 1929 there were 9,136 shareholders of B stock alone. In 1933 there were 41,000 stockholders and in April 1936 there were 52,000 holders of B stock.

In 1924 petitioner sold for cash 21,067 shares of the stock purchased in 1921 from United Retail Stores. The sales were made in the second and third quarters of 1924 on a rising market, following a substantial drop of the market in the first quarter.

In 1925 the petitioner sold for cash 11,000 shares of the stock purchased in 1921 from United Retail Stores. These shares were sold or reissued between February 10 and August 13, 1925. The management took advantage of a rising market to dispose of these shares without hurting its stock or the reputation of the petitioner.

By reason of a charter amendment in 1926, the management of petitioner feared that speculators on the market might start a rumor that petitioner would declare a stock dividend. To protect the reputation of the stock, which included keeping it from jumping and precipitately dropping, the petitioner purchased through a broker for cash, 21,400 shares of its stock. After fear of the rumor had passed, the 21,400 shares were gradually fed back into the market.

In 1927 the petitioner's only transaction respecting its own stocks was the disposition of certain fractional shares accumulated in its hands in connection with the issuance of rights to subscribe or  
26 receive additional stock. These fractional shares, which had cost petitioner nothing, were disposed of for cash in the amount of \$240.83.

During April 1928, petitioner reduced the price of its cigarettes from \$6.40 to \$6 per thousand. Following this reduction the volume of petitioner's stock offered on the market was greatly multiplied. Petitioner, with a view to protecting the reputation of the stock of the company, its business and its brands, purchased for cash 43,300 shares of its stock, expecting thereby to protect the market against a precipitate fall in prices. After the market steadied the 43,300 shares were fed back into the market, together with 1,240 shares of the stock acquired from United Retail Stores in 1921.

During each of the aforesaid years 1924 to 1928, inclusive, the petitioner, R. J. Reynolds Tobacco Co., reissued solely for cash, certain shares of its new class B common stock, theretofore acquired solely for cash, in a manner similar to that hereinafter set forth with respect to the taxable year 1929. Such transactions were made under circumstances and for reasons substantially similar to those surrounding the said similar transactions in the year 1929. For the purpose only of showing generally the result of such transactions during each of said years 1924 to 1928, inclusive, and for no other purpose, it is agreed that, in executing its income tax return for each of such prior years, the petitioner noted in "Schedule L—Reconciliation of Net Income and Analysis of Change in Surplus" and under subtitle (of said sched-

ule L) entitled "2. Non-taxable income \* \* \* (f) Other Items of Non-Taxable Income (to be detailed)" under the notation "Profit R. J. R. Stock," or substantially similar notation, the following amounts:

Years	Amounts
1924-----	\$999,335.25
1925-----	601,507.42
1926-----	85,003.70
1927-----	240.83
1928-----	1,271,023.19

At the close of 1928 petitioner had 30,000 shares of its new class B common stock, which became 75,000 shares by January 31, 1929, due to a 2½ for 1 split-up approved by the stockholders on December 28, 1928, thus reducing the par value of the stock from \$25 per share to \$10 per share.

Subsequent to January 31, 1929, the petitioner canceled certificates representing 15,000 shares of said 75,000 shares and issued in lieu thereof new certificates representing 15,000 shares of new class B common stock to divers persons who delivered to petitioner the sum of \$708,690 in cash for said 15,000 shares. The 15,000 shares so disposed of by petitioner were acquired as a part of petitioner's 1921 purchase at a cost to petitioner of \$121,440.19 in cash.

On December 18, 1929, 2,106,139 shares, or more than 23 percent of the total outstanding 9,000,000 shares of petitioner's new class B common stock, were in the hands of brokers, subject to trading or speculation. This stock was in a position to do great injury to petitioner, its stock, and its products. Approximately 2,000 employees of petitioner held shares of its stock and many of them had borrowed heavily on their stock. With the then market price of approximately 64, a heavy drop in the market would have been disastrous to many of petitioner's employees.

At the time of the market break in 1929 petitioner had \$29,000,000 in cash and Government securities, which the management determined to and did use in purchasing the petitioner's stock offered on the market during the break in October and November 1929. During the height of the stock market panic, from approximately October 29 to November 13, 1929, petitioner held the market price of its stock at 50, purchasing 90 per cent of its stock offered on the market. As the panic eased, petitioner's purchases were scaled down to 40 and 39. During the taxable year 1929 petitioner purchased a total of 574,880 shares of its own stock.

In addition to selling the 15,000 shares aforementioned during 1929, petitioner sold 194,000 other shares of the new class B common stock it had purchased in 1929. One block representing 94,500 shares of new class B common stock was acquired by petitioner for cash in the amount of \$4,908,966.17. Later in 1929 petitioner canceled the certificates representing these 94,500 shares, issuing new class B common stock certificates in lieu thereof to divers persons for \$4,506,497 in cash. Another block of 99,500 shares of new class B common stock

28 was acquired by petitioner in 1929 for \$4,601,807.43 in cash. Later in 1929 petitioner canceled the certificates representing these 99,500 shares, issuing new class B common stock certificates in lieu thereof to divers persons for \$4,703,608 in cash. The transactions covering the said 94,500 and 99,500 share blocks of stock were handled by brokers on the New York Stock Exchange.

At all times during 1929 the stock books and records of the petitioner indicated that the number of its new class B common stock issued and outstanding was 9,000,000 shares. From the time of acquisition of the certificates representing shares of petitioner's stock until the time of their cancellation and the issuance of new certificates in lieu thereof, the said certificates were regularly entered and recorded on the balance sheets in the financial statement of petitioner under the entry "Investments in Non-competitive Companies," in which all of such stock was entered and carried at the amount of cash for which it was acquired. The said transactions in respect thereof were not entered or recorded in any records of petitioner as either increasing or reducing the number of the outstanding shares of its capital stock. At the times of the acquisitions by petitioner of certificates representing its capital stock, as set forth hereinabove, the cash of petitioner was reduced by the amounts of cash expended for their acquisition. Likewise, at the times in 1929 when the said certificates were disposed of, the cash of petitioner was increased by the amounts received from the disposition thereof.

At the close of the taxable year the petitioner had on hand 431,925 shares of its new class B common stock. As of December 31, 1929, these shares represented \$19,270,690.98 out of the \$19,601,594.77 total appearing on petitioner's books in the amount designated "Investments in Non-competitive Companies." The balance of the account represented investments in the stock of two small licorice companies (from which petitioner secured its supplies of licorice) and stock in the Glenn Tobacco Co. None of the shares of stock of the last mentioned three companies was for sale or was traded in by petitioner.

The profit from the sale by petitioner of its own shares of stock arose solely through the sale of new class B common stock. The stock certificates covering the shares sold in 1929 were endorsed, surrendered, canceled, and reissued in the same normal manner as sales and purchases of all of petitioner's shares of stock. Each transaction involved herein was a completed and closed transaction in the taxable year 1929. During 1929 each and every acquisition and each and every sale made by petitioner of its own stock was for cash and in no instance for anything except cash.

29 Petitioner's 1929 income tax return, schedule L, indicates a non-taxable profit of \$436,581.21. It is stipulated that the last mentioned figure should be reduced by a \$150,000 dividend to \$286,581.21. The \$436,581.21 item is reflected in petitioner's books as a cash item. The item went into petitioner's surplus account and was included in the

financial statement of the company made to its stockholders. It was carried as a nontaxable item in accordance with petitioner's understanding of what it was and because of Treasury Department regulations.

In his examination and audit for the year 1929, the respondent has not heretofore included as taxable income or deductible loss any amount arising out of, or resulting from, the transactions hereinabove recited.

The parties stipulated with respect to the original deficiency as follows:

14. It is the intent and desire of the parties here to dispose of (by agreement with the approval of the Board of Tax Appeals), all of the issues presented in the petition filed herein on May 4, 1933. In the deficiency letter dated April 2, 1933, from which this appeal was taken, the Commissioner determined that the petitioner realized a taxable profit for 1929 of \$145,475.44 from the liquidation of the Tobacco Foil Company, Richmond, Virginia, and/or Winston-Salem, North Carolina. It is hereby stipulated and agreed that, for the purpose of this appeal, such profit should be reduced to \$71,196.64. It is further agreed that the net taxable income for 1929, in the amount of \$38,497,056.05, as determined by the Commissioner (in the said deficiency letter) should be reduced by \$74,278.80—being the difference between \$145,475.44 and \$71,196.64, above mentioned; the tax should be recomputed accordingly.

15. By reason of the addition to taxpayer's net taxable income of the amount of \$71,196.64, as set out in paragraph 14 hereinabove, the taxpayer's income tax due thereon to the State of North Carolina amounts to \$2,774.13, and the similar income tax to the State of Virginia amounts to \$16.61, both of which said amounts properly constitute deductions in computing the net taxable income of this taxpayer for purposes of Federal income tax. It is, therefore, stipulated that in the final computation of deficiency in the instant cause, the said amounts of \$2,774.31 and \$16.61 should be allowed as additional deductions from income of this taxpayer; the tax should be recomputed accordingly.

#### OPINION

VAN FOSSAN: The sole issue in this case is whether petitioner by purchasing shares of its own stock, for cash, and later canceling the certificates and selling and issuing new certificates representing such shares for cash, realized a taxable gain. The amount of gain, the acquisitions and dispositions by petitioner of its own stock, the cost and sale prices thereof, and all other material facts are undisputed. There is only the question of law, whether the profit on the several transactions, \$436,581.21, is taxable income. By stipulation of the parties this sum is reduced to \$286,581.21 because of a \$150,000 dividend.

At the time petitioner's tax return was made the regulations of the Treasury Department, article 66, Regulations 74,<sup>1</sup> provided that "a corporation realizes no gain or loss from the purchase or sale of its own stock." Petitioner's return conformed to the regulations then in force, as it reported therein nontaxable income of \$436,581.21 under the notation "Profit R. J. R. Stock." This was in accord with the manner in which petitioner had reported similar transactions for the years 1924 to 1928, inclusive, as hereinabove set forth.

31 Under date of May 2, 1934, article 66, Regulations 74, together with article 543, Regulations 65 and 69, and article 66, Regulations 77, being the regulations under the Revenue Acts of 1924, 1926, 1928, and 1932, was amended by Treasury Decision 4430.<sup>2</sup> Following this amendment of his regulations, respondent determined that the petitioner herein realized a net taxable profit from "trafficking" in its own stock in 1929. His determination gives effect to the losses sustained on some transactions and to the profits realized on others. By this amended answer respondent asks that petitioner's tax liability for 1929 be increased accordingly.

In his brief respondent admits that T. D. 4430 changes a long standing departmental construction, and he concedes it to be a well established rule of law that long continued executive construction contained in regulations must be deemed to have received legislative approval by the reenactment by Congress of the same statutory provision without substantial change. However, he asserts that this rule is to be applied only when it "does no violence to the letter or spirit of the provisions construed," *Brewster vs. Gage*, 280 U. S. 327, 336, and where the regulation operates to create a rule out of harmony with the statute, the regulation is a mere nullity, *Manhattan General Equipment Co. vs. Commissioner*, 297 U. S. 129, affirming 29 B. T. A. 395; *Lynch vs. Tilden Produce Co.*, 265 U. S. 315; *Miller vs. United States*, 294 U. S. 435, and cases cited at page 440; *Schafer vs. Helvering*, 83

<sup>1</sup> ART. 66. Sale by corporation of its capital stock.—The proceeds from the original sale by a corporation of its shares of capital stock whether such proceeds are in excess of or less than the par value of the stock issued, constitute the capital of the company. If the stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount is not a loss deductible from gross income. If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the shareholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock. (See article 176.)

<sup>2</sup> Acquisition or disposition by a corporation of its own capital stock.—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon the original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of applicable statutes.

Fed. (2d) 317. He submits that the amended regulation is a reasonable interpretation of the Congressional intent expressed in the statute.

32. The statutory provisions which the original regulation, article 66, Regulations 74, and the amendment thereto, T. D. 4430, *supra*, interpret are contained in section 22 of the Revenue Act of 1928, wherein the Congress defines "gross income."<sup>3</sup> As pointed out by counsel for petitioner in their brief, the interpretation and administration of this section of the statute in like or similar situations to that here obtaining have been uniform under all revenue acts, with the possible exceptions hereinafter noted, until the promulgation of respondent's T. D. 4430 on May 2, 1934.

This uniformity of construction and administration of the statute is one of the two principal arguments upon which petitioner rests its case. With great care petitioner's brief dovetails the regulations, rulings, and decisions of the Commissioner, the decisions of this Board, and the decisions of the courts, with the passage of the several revenue acts, in order to show the repeated reenactment of the definition of "gross income" after such regulations, rulings, and decisions were promulgated or made. Petitioner submits that over this period of approximately 21 years the repeated reenactment of the definition without change, modification, or amendment constitutes legislative approval and adoption of the departmental interpretation. Our attention is particularly directed, *inter alia*, to the decisions of the Supreme Court in *Old Colony Railroad Co. vs. Commissioner*, 284 U. S. 552; *Helvering vs. Bliss*, 293 U. S. 144; *Old Mission Portland Cement Co. vs. Helvering*, 293 U. S. 289; *McFeeley vs. Helvering*, 296 U. S. 102, and *Koshland vs. Helvering*, 298 U. S. 441.

These decisions, and the others considered, establish the rule that great weight should be given "to an administrative interpretation long and consistently followed, particularly when the Congress, presumably with that construction in mind, has reenacted the statute without change \* \* \* (citing cases)." In addition, these decisions establish the rule that where a statute "uses ambiguous

33 terms, or is of doubtful construction, a clarifying regulation or one indicating the method of its application to specific cases not only is permissible but is to be given great weight by the courts." And finally these decisions establish that "the same principle governs where the statute merely expresses a general rule and invests the Secretary of the Treasury with authority to promulgate regulations appropriate to its enforcement," *Koshland vs. Helvering*, *supra*. It is this latter rule which petitioner desires to invoke in this proceeding.

<sup>3</sup> SEC. 22. GROSS INCOME.

(a) General definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transactions of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

However, there is another rule of equal importance which the Supreme Court has stated and restated many times. This rule is to the effect that if the departmental construction is obviously or clearly wrong, the Court will so hold, regardless of the long continued practice in administering the act. *United States v. Graham*, 110 U. S. 219; *Wisconsin Central Railroad Co. vs. United States*, 164 U. S. 190; *Manhattan General Equipment Co. vs. Commissioner*, *supra*; *Koshland vs. Helvering*, *supra*. The Supreme Court has variously stated the rule, always to the same effect, that long continued departmental construction “\* \* \* is not to be overturned unless clearly wrong, or unless a different construction is plainly required,” *United States vs. Jackson*, 280 U. S. 183, 193: “\* \* \* will not be disturbed except for weighty reasons,” *Brewster vs. Gage*, 280 U. S. 327, 336; “\* \* \* ought not to be disturbed now unless it be plainly wrong,” *Universal Battery Co. vs. United States*, 281 U. S. 580, 583; “\* \* \* will not be overruled except for weighty reasons,” *Fawcett Machine Co. vs. United States*, 282 U. S. 375, 378; “\* \* \* will not be judicially disturbed except for reasons of weight \* \* \*,” *McCaughn vs. Hershey Chocolate Co.*, 283 U. S. 488, 492.

These decisions, and others of similar tenor, expressly point out that circumstances may arise where the Court will refuse to follow the departmental construction, even though long continued and followed by subsequent reenactments by the Congress of the statutory section in question. In two recent decisions, *Manhattan General Equipment Co. vs. Commissioner*, *supra*, and *Koshland vs. Helvering*, *supra*, the Supreme Court repudiated the departmental construction. In the *Manhattan* case the original regulation was amended, as it has been here, and the question turned, as here, upon “whether the 34 loss (or gain) was to be determined in accordance with the original or the amended regulation.” The Court held that the amended regulation correctly expressed the will of Congress. In the *Koshland* case the regulations had continued to the same effect, even after repeated decisions by the Supreme Court indicated their error, with the result that when the question was finally presented to the Court it expressly and decisively overruled the departmental construction.

As already stated, the situation here with respect to the original and amended regulations is analogous to the situation in *Manhattan General Equipment Co.*, *supra*. There the Court stated that “not only must a regulation, in order to be valid, be consistent with the statute, but it must be reasonable. *International Railway Co. vs. Davidson*, 257 U. S. 506, 514.” So here we must determine whether the amended regulation is consistent with the statute and whether it is reasonable.

Briefly summarizing the facts, it appears that petitioner acquired on the open market during the taxable year 574,880 shares of its own stock, for which it paid cash. During the taxable year it sold 209,000 shares of its own stock for cash. The excess of the sums received over the sums paid out in the various transactions in its own stock amounted to \$436,581.21.

Considering the magnitude and extent of petitioner's operations during the taxable year, it could hardly be denied that it was dealing "in its own shares as it might in the shares of another corporation." T. D. 4430, *supra*. There were trades between opposing parties in a large number of transactions negotiated through brokers. The stock was not retired. If petitioner's transactions had been in the shares of stock of another corporation, no one would be so bold as to deny that it realized a net taxable gain therefrom. But petitioner says that since the transactions were in its own stock, no gain or loss resulted, because of the capital nature of each transaction. *Simmons & Hammond Manufacturing Co.*, 1 B. T. A. 803; *Hutchins Lumber & Storage Co.*, 4 B. T. A. 705; *Union Trust Co. of New Jersey*, 12 B. T. A. 688; *J. H. Johnson*, 19 B. T. A. 840; *affd.*, *Johnson vs. Commissioner*, 56 Fed. (2d) 58; *certiorari denied*, *Johnson vs. Burnet*, 286 U. S. 551; *Houston Brothers Co.*, 21 B. T. A. 804; *Jewel Tea Co. vs. United States*, 15 Fed. Supp. 56.

35 In *Houston Brothers Co.*, *supra*, the Board fully considered and carefully reviewed its prior decisions on this question, overruled its decisions in *Behlow Estate Co.*, 12 B. T. A. 1365, and *New Jersey Porcelain Co.*, 15 B. T. A. 1059, cases in which gain or loss was recognized in transactions involving the taxpayers' own shares of stock, and reaffirmed the principle announced in *Simmons & Hammond Manufacturing Co.*, *supra*. It is unnecessary again to cover this ground, particularly in view of the trend of decisions since *Houston Brothers Co.*

In *S. A. Woods Machine Co.*, 21 B. T. A. 818, the Board considered the same general principle and rested its decision, in part, at least, upon the determination in the *Houston Brothers Co.* case. Upon appeal, *Commissioner vs. Woods Machine Co.*, 57 Fed. (2d) 635 (C. C. A., 1st cir.), *certiorari denied*, 287 U. S. 613, the Circuit Court of Appeals reversed the Board. In the *Woods* case the corporate taxpayer received shares of its own stock in settlement of a patent infringement suit. The corporation retired the capital stock so received, but nevertheless the court held that taxable gain resulted. In determining the issue the court considered the statutory definition of "gross income" and the regulation interpreting the definition, section 213, Revenue Act of 1924, and article 543, Regulations 65, which are to all intents and purposes the same as section 22, Revenue Act of 1928, and article 66, Regulations 74. In the course of its opinion the court stated:

Whether the acquisition or sale by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction involved. *Walville Lumber Co. vs. Com. of Internal Revenue* (C. C. A.), 35 F. (2d) 445; *Spear & Co. vs. Heiner* (D. C.), 54 F. (2d) 134. If it was in fact a capital transaction, i. e., if the shares were acquired or parted with in connection with a readjustment of the capital structure of the corporation, the Board rule applies. *Doyle vs. Mitchell Bros. Co.*, 247 U. S. 179, 184, 38 S. Ct. 467, 62 L. Ed. 1054; *Eisner vs. Macomber*, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570. But where the transaction is not of

that character, and a corporation has legally dealt in its own stock as it might in the shares of another corporation, and in so doing has made a gain or suffered a loss, we perceive no sufficient reason why the gain or loss should not be taken into account in computing the taxable income. The view taken by the Board of Tax Appeals (see *Houston Brothers Co. vs. Commissioner*, 21 B. T. A. 804) presses accounting theory too far in disregard of plain facts. It is not supported by any decision which has come to our attention except those of the Board. In *Knickerbocker Imp. Co. vs. Board of Assessors*, 74 N. J. Law 583, 585, 65 A. 913, 915, 7 L. R. A. (N. S.) 885, the plaintiff corporation was held liable for the franchise tax on its own stock which it had bought and held in the treasury. The court said: "Stock once issued is and remains outstanding until retired and canceled by the method provided by statute for the retirement and cancellation of capital stock." (Dill, J.) In *United States vs. Kirby Lumber Co.*, 284 U. S. 1, 52 S. Ct. 4, 76 L. Ed. —, dealing with a question somewhat similar to the present one, the court said: "we see nothing to be gained by the discussion of judicial definitions. The defendant in error has realized within the year an accession to income, if we take words in their plain popular meaning, as they should be taken here." (Holmes, J.) See, too, *Maryland Casualty Co. vs. United States*, 251 U. S. 342, 40 S. Ct. 155, 64 L. Ed. 297. As has often been said, taxes are practical things and should be dealt with on a practical basis.

To the same effect are *Allyne-Zerk Co. vs. Commissioner*, 83 Fed. (2d) 525 (C. C. A., 6th Cir.), affirming 29 B. T. A. 1194; *Dorsey Co. vs. Commissioner*, 76 Fed. (2d) 339 (C. C. A., 5th Cir.), affirming memorandum opinion of this Board; certiorari denied, 296 U. S. 589.

In the last mentioned case the court specifically considered the last sentence of article 66, Regulations 74, supra, and the amendment thereto, T. D. 4430. In its opinion the court states:

The point of law dealt with by the Board is whether the transaction was controlled by the last sentence of Regulations 74, Art. 66: "A corporation realizes no gain or loss from the purchase or sale of its own stock." A reading of the whole Regulations, which had existed at least since 1918, shows that it referred mainly to the original sale of the capital stock and to stock turned back by stockholders to be resold to raise more capital. It was amended in 1934 by T. D. 4430 to distinguish clearly between original capital transactions and ordinary commercial dealings in its own stock as in that of another corporation. It may well be that a corporation taking its cash and buying its own stock makes neither gain nor loss by the mere purchase. That is true of any purchase for cash. But when in a business exchange for its real estate it receives in part its own stock it is converting by sale a previous purchase, and if what it receives has a fair market value the gain or loss realized in the exchange must be measured and taxed. It is not the purchase of the stock but the sale of the real estate that is regarded.

The petitioner contends that the *S. A. Woods Machine Co.* reversal in no wise involved or turned upon the principle of *Simmons & Ham-*

mond Manufacturing Co., which, it is asserted, is the present rule of the Board. It is so urged, despite the reversals of Board decisions in Schiller Piano Co., 23 B. T. A. 376; reversed on confession of error by Commissioner, Schiller Piano Co. vs. Commissioner, 58 Fed. (2d) 1085; Boca Ceiga Development Co., 25 B. T. A. 941; reserved, Commissioner vs. Boca Ceiga Development Co., 66 Fed. (2d) 1004; and despite the decisions of the Board in Houghton & Dutton Co., 26 B. T. A. 52; James D. Robinson, 27 B. T. A. 1018; *affd.*, Robinson v. Commissioner, 67 Fed. (2d) 972; Niagara Share Corporation, 30 B. T. A. 668.

While no one of the foregoing decisions specifically overruled the doctrine of Simmons & Hammond Manufacturing Co., *supra*, the decisions are at variance with the principle of the latter case. Indirectly, if not directly, Simmons & Hammond Manufacturing Co. has been overruled. In the Houston Brothers Co. case the Board stated, after its review of the authorities: "The foregoing considerations, in our opinion, demonstrate the soundness and wisdom of the rule of the regulations and of the Simmons & Hammond case. When a corporation engages in a transaction which involves the receipt or disposition of its own shares, no gain or loss is recognizable in determining its taxable income." The Houston case was not appealed, but the principle upon which it was decided was expressly repudiated by the court in Commissioner vs. Woods Machine Co., *supra*, wherein it is stated that the Houston decision "presses accounting theory too far in disregard of plain facts."

38 An examination of the Simmons & Hammond manufacturing Co. case, *supra*, reveals certain facts analogous to those in this proceeding. There the corporate taxpayer purchased 94 of the 323 shares of its own outstanding stock from four stockholders. It paid three stockholders \$6,800 cash for 34 shares and paid one stockholder \$8,697.40 in cash and \$5,449.61 in property of the company for 60 shares. During the same taxable year the corporation sold the 94 shares, purchased at a cost of \$20,947.01, to its two principal stockholders, 47 shares each, for the sum of \$10,340, and claimed a loss as a result thereof of \$10,607.01. The Board refused to allow the loss, holding that the purchase and resale by the corporation of 94 shares of its own stock "constituted a capital transaction"; that by the purchase of its own stock the corporation sustained no loss; that the resale of the stock resulted in no loss to the corporation; and that the method used by the corporate taxpayer "was in truth and in fact a distribution of surplus" to its two principal stockholders, Simmons and Hammond.

Under the facts in this proceeding we are unable to see how it could be said that petitioner's purchases and sales of its own stock were, in truth and in fact, distributions of its surplus. The various transactions in its own stock were directed toward remedying a harmful situation among the retailers of its products, toward protecting its employees, its trade brands, and its business, and in pursuance of a long established policy of widening its stockholding base. We have found no evidence in this record indicating that distribution of the corpora-

tion's surplus was the objective of these transactions. The fact is that petitioner's cash was reduced with each purchase and increased after each sale by the proceeds thereof, and that during the interval between purchase and sale the shares appeared in an account designated "Investments in Non-competitive companies."

As above noted, the record establishes that the primary purposes of the corporation in buying and selling its own stocks were to get wider stock ownership and to support the market, both normal business motives frequently employed. Albeit there is no testimony that the immediate profit motive was present, the reader of this record would be naive indeed who would not observe such a motive interlarded in the entire situation. The instant tax year does not present an isolated instance. It presents merely the current result of a practice extending over a period of several years.

39 Another contention upon which petitioner rests its case is that a corporation's own stock is not "property" or "assets" in its own hands, citing *People vs. Kelsey*, 93 N. Y. S. 369; *Stevens vs. Olus Manufacturing Co.*, 130 N. Y. S. 22; *Borg v. International Silver Co.*, 11 Fed. (2d) 147. We find little of assistance in these cases. One phrase from the Borg case is noteworthy, however, and that is where the court, in making its pronouncement of its conclusion, states: "It makes no difference whether this satisfies ideal accounting or not." We are not concerned with the bookkeeping entries that would be required to record the transactions in petitioner's own stock, nor is it material to our purposes whether the increment of gain be denominated "contingent profits" or be called by some other name.

The courts of the various states have established by an overwhelming weight of authority that a solvent corporation can purchase and hold its own shares of stock, and the question of whether it holds the purchased stock as an asset is largely a matter of intent. *Pabst vs. Goodrich*, 133 Wis. 42; 113 N. W. 398, and cases cited; *Draper vs. Blackwell & Keith*, 138 Ala. 182; 35 So. 110; *City Bank vs. Bruce*, 17 N. Y. 507; *Johnson County vs. Thayer*, 94 U. S. 631; *Adam vs. New England Inv. Co.*, 33 R. I. 193; 80 Atl. 426; *Scriggins vs. Dalby Co.* (Mass., 1935), 195 N. E. 749; *San Antonio Hardware Co. vs. Sanger* (Texas), 151 S. W. 1104; see also note in 61 L. R. A. 621 and discussion of *Leland vs. Hayden*, 102 Mass. 542, appearing at page 623; *Cook on Corporations*, §§311, 313; 7 R. C. L. 551, "property" includes corporation's own stock; and 7 R. C. L. 552 regarding corporate intent.

This petitioner held its shares in its treasury with the unquestioned intention of selling and reissuing them, preferably by placing the stock in the hands of permanent investors. The technical status of the stock while in its hands concerns us little.

Petitioner advances as a further argument in opposition to taxing the gain resulting from petitioner's transactions that the purchases and the sales were capital transactions which affected the corporation's capital structure. This argument is fully met by the pro-

visions of the amendment to the regulations. So far as transactions, capital in their nature, are concerned, T. D. 4430, *supra*, expressly and correctly excludes them from classification as taxable transactions. It seeks to reach only those transactions which are actually and in truth ordinary commercial dealings by a corporation in its own stock. The fallacy in petitioner's position is that its dealings in its own stock do not fall within the category of capital transactions.

To hold the contrary and sustain petitioner's position that no taxable profit accrues when a corporation, with no proven purpose of effecting changes in its capital structure, goes into the market and buys its own stock, places and holds the same in its investment account and then, a favorable opportunity presenting itself, sells the same through the market at a higher price than it paid for the same, would require us to engage in the exploration of the metaphysical concepts of accounting far beyond the realm of practical legal reasoning. It "presses accounting theory too far in disregard of plain facts."

We have observed that the Supreme Court has held that a regulation or administrative practice which has been long followed and has received legislative sanction should not be overturned except for weighty reasons. That such regulation or practice is based on a false premise; that it elevates to a position of authority a concept which runs counter both to reason and ordinary business judgment; that it prefers a highly artificial interpretation to the usual rationale of normal minds would seem to be "weighty reasons" for dethroning such a regulation or practice.

In our opinion the regulation, as amended, is reasonable, and is consistent with the statute. The prior regulations do not meet these tests. Therefore, the respondent's determination is approved.

In so far as Simmons & Hammond Manufacturing Co., *supra*, and cases following it conflict with this decision, they are hereby overruled.

If, as a result of our decision herein, petitioner's taxes to the States of Virginia and North Carolina are thereby increased, provision should be made for proportionately increasing petitioner's allowable deductions.

Reviewed by the Board.

Decision will be entered under Rule 50.

MORRIS, MURDOCK and LEECH dissent.

ARUNDELL and TURNER did not participate in the consideration of or decision in this report.

on June 17, 1937. The case was called for settlement on July 14, 1937, at which time no objection was offered to the respondent's proposed recomputation of the tax. It is therefore

Ordered and decided: That there is a deficiency in income tax for the year 1929 in the amount of \$37,865.62.

(s) EUGENE BLACK,  
Chairman.

Enter:

Entered July 16, 1937.

In United States Circuit Court of Appeals for the Fourth Circuit

[Title omitted.]

*Petition for review*

Filed October 12, 1937

*To the Honorable, the Judges of the United States Court of Appeals for the Fourth Circuit:*

42 R. J. Reynolds Tobacco Company, the petitioner, in support of this, its petition, filed pursuant to the provisions of sec. 1001 of the Act of Congress entitled the Revenue Act of 1926 (as amended by sec. 1001 of the Revenue Act of 1932), for the review of the decision of the Board of Tax Appeals, rendered on the 16th day of July, 1937, determining and ordering deficiencies in income tax of petitioner for the calendar year 1929, in the amount of \$37,865.65; and shows to the Court as follows:

# I

The Commissioner determined a deficiency in income tax in the amount of \$15,990.65 for the calendar year 1929, and on April 3, 1933, he mailed to petitioner a Notice of Deficiency in the same amount.

In his said Notice of Deficiency the Commissioner advised the taxpayer that the said deficiency was based upon his determination that the taxpayer had realized a profit of \$145,475.44 from the acquisition and subsequent liquidation of a corporation known as Tobacco Foil Products Company.

On May 4, 1933, petitioner filed an appeal from the said Notice of Deficiency, in the Board of Tax Appeals.

Thereafter petitioner and respondent agreed and stipulated that the Commissioner's determination of profit (of \$145,475.44) on the above mentioned transaction was erroneous to the extent of \$74,278.89, and that the correct profit to be added to gross income was \$71,196.64.

On February 13, 1936, respondent filed an "Amended Answer" in this cause, and therein pleaded and raised a new and affirmative issue, not theretofore appearing in this cause. The new issue thus presented herein was based upon such subsequent determination of the Commissioner that petitioner had realized taxable profits and taxable

income by reason of certain acquisitions of its own common capital stock for cash, and the subsequent re-issue of a portion thereof in 1929, for cash. The facts surrounding the said transactions are set out *infra* herein.

On March 14, 1936, petitioner filed Reply to respondent's Amended Answer and denied that it had realized taxable profits or income upon any of said transactions and in bar of respondent's claim pleaded the

43 Regulations of the Treasury Department; the opinions, rulings, decisions and determinations of the Commissioner, the Secretary of the Treasury and the General Counsel; the opinions, decisions, order and judgments of the Board of Tax Appeals, and of various courts and tribunals which specifically ruled and held that a corporation did not realize a taxable profit nor sustain a deductible loss solely upon the acquisition by it of shares of its own stock or upon the issuance or disposal by it to others of such shares of its own stock.

The cause came on for hearing in the Board on April 27, 1936, at which hearing petitioner and respondent filed a stipulation of certain material facts, and at which hearing competent and material evidence in the form of the testimony of Mr. S. Clay Williams, former president and now Chairman of the Board, of petitioner, was submitted.

Thereafter, on April 27, 1937, the Board promulgated an opinion, decision, and findings of fact in the said cause. Three members of the Board dissented and two did not participate. Therein the Board decided that petitioner's transactions in the year 1929, by which it reissued for cash its own common stock, theretofore acquired by it for cash, were taxable transactions from which a taxable profit or income resulted in the amount of \$286,581.21.

On July 16, 1937, the Board entered a decision ordering that there is a deficiency in income tax for the year 1929 in the amount of \$37,865.62.

## II

The nature of the controversy is as follows:

For many years, and since the inauguration of the income tax, the Secretary of the Treasury, the Commissioner of Internal Revenue, and the General Counsel of said Bureau, had ruled, decided, and held that if a "corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation" and that "a corporation realizes no gain or loss from the purchase or sale of its own stock." Regulations so construing the taxing statutes were promulgated by the

44 Treasury Department under early revenue acts. Each successive revenue act was enacted in light of such construction, and each revenue act was followed by regulations placing the same construction upon it. This continued for approximately 21 years and during that time some seven or eight revenue acts had been enacted and appropriate regulations promulgated pursuant to each of them; and during

said period the Treasury Department had periodically and consistently issued rulings and decisions in support of such regulations. Likewise, during such time the Treasury Department had continuously applied this doctrine in income tax cases arising under the various revenue acts. While the number of such decided cases cannot be now definitely known, their number was, without doubt, many thousands. When the Board of Tax Appeals was organized this issue was early presented to it, and the Board affirmed the correctness of the said Treasury ruling in a large number of decided and published cases. In light of such Board decisions and opinions, at least four of said revenue acts became law, and identical regulations and rulings were duly promulgated pursuant thereto. These rulings, decisions, opinions, and regulations (of the Treasury, the Bureau, and the Board) were applied uniformly and consistently, and the rule and doctrine thereby established was well known and recognized and became as well recognized, established, and settled as legislative history, uniformity of practice, and long and consistent application can make it. The law, the regulations, the rulings, decisions, and opinions stood in this wise in the year 1929 (under the Revenue Act of 1928) and for about 6 or 7 years thereafter, during which subsequent period two further revenue acts were enacted without change, and identical regulations and rulings were promulgated under them.

In the year 1929 the transactions in question here occurred.

In the year 1934 the Department issued a Treasury Decision (T. D. 4430) purporting to change existing Regulations. This ruling was incorporated into Regulations 86, which were promulgated in the year 1935. The Commissioner construed said Treasury Decision in its application to the 1929 transactions of this petitioner, so as to overturn the long continued doctrine and rule above outlined, and so as to hold taxable a transaction in which this petitioner ac-

45 certain of its common capital stock for cash and which it held as treasury stock for varying periods as long as 8 years and, after cancelling the same, re-issued such stock for cash to divers persons who, upon such acquisition, became stockholders of the company. To apply to petitioner's transactions in 1929, the said Treasury Decision was applied retroactively over a period of approximately 12 years. The circumstances were as follows:

Petitioner is a New Jersey corporation with principal office and place of business in Winston-Salem, N. C. Its income tax return for 1929 was filed with the Collector of Internal Revenue for the District of North Carolina. Petitioner is engaged in the manufacture and sale of tobacco products, including plug, twist, smoking tobacco, and cigarettes. Its only outstanding stock was common stock. Its capitalization was as follows:

1,000,000 sh. Common Stock (sometimes referred to as Class A common stock) at \$10 par value.....	\$10,000,000
9,000,000 sh. New Class B Common Stock at \$10 par value.....	90,000,000
10,000,000 sh. common stock.....	\$100,000,000

The difference between these two classes of common stock (Common Stock and New Class B Common Stock) is that the latter had no voting power, while the former had voting power and participation in certain profits of the company when held by officers and employees of the company.

In 1912 the petitioner was young in the tobacco industry, being a relatively small corporation with only a small number of stockholders. As late as 1922 there were less than 2,000 stockholders of both classes of stock. Its principal stockholder and founder was R. J. Reynolds, whose practice it was to bring as many employees as possible into the company as stockholders. At 1912 petitioner was in vigorous competition with three other tobacco companies, each having many times the capital of petitioner. After 1912 its growth was rapid. Its business prospered to such an extent that maintaining the capitalization of the company at a point where it could support the rapid expansion of the business, and meet competitive conditions, presented a serious problem. Petitioner had come to the realization that it was of the greatest importance that the reputation of the company and of its stock be preserved and that such reputation would depend to a great extent on the behavior of the stock in the market, including its behavior in comparison with other similar stocks, and upon a wider spread of its stockholding base. The confirmation of this realization was not long deferred.

In July, 1918, R. J. Reynolds died. He was petitioner's largest stockholder. It was necessary for his estate to sell a substantial portion of petitioner stock in order to pay taxes on his estate. The stockholders of the company were comparatively few and were not enough to absorb the stock that had to be sold by the founder's estate. Not long afterwards this stock came into the hands of United Retail Stores, which controlled United Cigar Stores Co., a large distributor of petitioner's products. False rumors developed and the suspicion grew that United Retail Stores was dictating petitioner's business policies and was able to buy petitioner's products at lower prices and for better discounts than other distributors and retailers. Besides, the dividends paid by petitioner made it possible for United Retail Stores to operate its large chain of retail stores (about 2,000 in number) without any profit and yet be able to pay dividends to its own stockholders on its own stock.

This was a source of embarrassment and peril to petitioner, and it was realized that the reputation of the company and the necessity of protecting its business and its assets required that this stock be acquired from United Retail Stores. As stated above, petitioner had realized the danger to it of its small stockholders' base and this danger was brought home to it when Mr. Reynolds died and a large block of petitioner's stock had to be sold by his estate, and a further danger became apparent when that large block of stock became centralized in United Retail Stores, as above recited. Petitioner realized that it was of the highest importance to broaden its stockholding base, and the acquisition of the large block of stock from

United Retail Stores would afford it the opportunity to remove a dangerous and harmful situation, and at the same time to  
 47 expand its stockholders' list by causing that stock to be distributed widely among the public.

For the above reasons petitioner began negotiations for the acquisition of the said stock, and in 1921 acquired said stock for cash in the amount of \$607,200.96. Thereafter, due to stock dividends and splits, a portion of the stock acquired came to represent 75,000 share of new Class B Common Stock held by the company at January 31, 1929, which was about 8 years later.

In accordance with its determination to build up its stockholding base and save the company from further dangers such as had been averted, as aforesaid, petitioner from time to time re-issued the said stock to persons desiring to become stockholders of the company. This policy proved successful and effective in improving the company's stockholding base and the company availed itself of the opportunities thus presented for extending its stockholding base. The company considered this policy vital to its existence and success. The effectiveness of this policy is evidenced by the increase of petitioner's stockholders. In March 1922, when petitioner's stock was first listed on the Stock Exchange, petitioner had less than 2,000 stockholders (counting both common stock and Class B stock). By 1929 there had been an increase in stockholding base in Class B stock alone of more than 450%, there being 9,136 stockholders in that year of Class B stock alone. By 1933 there were 41,000 (an increase of over 2,000%) and in April 1936 there were 52,000 (an increase of over 2,600%) stockholders of B stock alone. As stated above, in January 1929 petitioner still held 75,000 shares of B stock, out of the 1921 acquisition from United Retail Stores, which it had not yet re-issued. The company had observed the sound policy of re-issuing this stock in such way as to protect and uphold the reputation of the company, its stock, its business, and its brands and trade marks.

But difficulties and dangers to the company again threatened from time to time. By reason of a proposed charter amendment in 1926, the management of petitioner anticipated that speculators in the market might start a false rumor that petitioner would declare a stock dividend. While such a rumor would have been false, yet petitioner feared that such speculators might injure the reputation of the company and its stock by causing the stock to jump precipitately  
 48 on the market and then fall precipitately when the rumor was proven to be untrue. In an attempt to prevent such an unwarranted fluctuation of the stock on the market based on such a false rumor, petitioner in 1926, prior to the call of the meeting looking to the proposed charter amendment changing its capital structure, acquired for cash 21,400 shares of its new Class B Common Stock. This action was taken as a precautionary measure to provide a cushion against such anticipated speculations in the market. After the proposed change in the company's capital structure had been effected and after the fear of said rumors had passed, the stock was gradually re-issued for cash upon demand for it by the public.

Still another danger faced the company in 1928. In that year it reduced the price of its cigarettes from \$6.40 to \$6 per thousand. This caused a heavy selling of petitioner's stock in the market and threatened to cause a serious break in the market for petitioner's stock. In order to avert this danger and to protect its reputation, its stock, its business, and its brands, the company acquired in the open market 43,300 shares of its own stock to prevent a precipitate fall in the market. When the market steadied this stock was gradually re-issued to the public upon demand therefor.

Between 1924 and 1928, inclusive, petitioner had re-issued to persons desiring to acquire Reynolds stock, various portions of the stock it had acquired in the transactions above recited. Such stock was always issued for cash and never in any transaction involving the sale of merchandise. Every such transaction was made under circumstances and in a manner similar to those in 1929, hereinafter outlined, and every such transaction in those years and in 1929 was made under similar circumstances and for reasons substantially similar to those above outlined. For each of the said years 1924 to 1928, inclusive, petitioner filed income-tax returns and set forth each such transaction and reported the results of each such transaction as non-taxable income, for the reasons that the regulations, rulings, and decisions of the Treasury Department and of the Board specifically held that the transactions were non-taxable under the law, and those regulations, rulings, and decisions specifically held that such transactions constituted adjustments to capital surplus and in no way affected the status of taxable income. The Commissioner so treated each tax return of petitioner for each of such years, and, after examination and determination, closed the returns of petitioner on such basis.

At the close of 1928 petitioner had in its treasury 30,000 shares of its own stock which it had acquired under the circumstances and for the reasons hereinabove stated. On January 31, 1929, these 30,000 shares became 75,000 shares due to a  $2\frac{1}{2}$  for 1 split-up, which reduced the par value of the company's stock from \$25 to \$10 per share.

After this split-up the company continued as before to re-issue such shares upon public demand therefor. In every instance, both before and at this time, the stock certificates acquired by the company were cancelled and when the stock was re-issued it was represented and evidenced by new certificates issued by the company. The company so issued 15,000 shares of the 75,000 held by it on January 31, 1929, as set out in the last preceding paragraph.

Later in 1929 another grave danger threatened the company. The magnitude of this danger was greater than any of those previously recited. A very large number (2,106,139) of shares had been acquired by brokers, subject to trading or speculation. This was more than 23% of the outstanding shares of the company. When the collapse of the market took place this stock was in a position to do great injury to the petitioner, its stock, and its products. It constituted a serious

menace. Approximaely 2,000 employees of the company had shares of its stock and many of them had borrowed heavily on their stock. With the then market price of about 64, a precipitous drop in the market would have been disastrous to many of them and the situation was fraught with peril for the company. In line with its decisions in previous crises, the company determined to, and did, support the market for its stock during the break in October and November 1929, and during the height of the panic in that period it sustained the market price of its stock at 50. In order to accomplish this it was necessary for the company to take 90% of the amount of offerings of its own stock thrown on the market. If the company had refrained from protecting its stock in this way the market would have dropped precipitously and the company would have been in position to have bought its stock at a far less figure than 50. As the panic eased  
50 petitioner attempted to withdraw its support from the market, with the result that its stock dropped to 40 and 39. For these reasons, and in this way only, the company acquired a large volume of shares of its own stock.

Like all the preceding transactions hereinabove recited in which it acquired such stock, the stock was acquired under circumstances of business duress and the reasons therefor in every case was to avert peril to the company, and for no other purpose. Likewise, in all instances the company used the opportunity to bring about a widening of its stockholding base and the widest possible spread of its stock among the public and to prevent the concentration of its stock in a few hands, with the grave dangers inherent therein to the company, its reputation, and its business. Accordingly the company, upon demand from the public therefor, issued new certificates representing such stock to the persons demanding and paying therefor. In this way the company acquired a great number of new shareholders and issued stock to them which it had acquired in the market panic of 1929, as well as other shares which it had acquired during the previous 8 years, as above set out.

In no instance was the company motivated by any aim or purpose other than herein set out. In no instance was there any margin trading. In no instance was the transaction entered into for the purpose of realizing a profit on its own stock. In no instance did the company trade or "traffic" in its own stock as that term is commonly used and understood. In every instance the transaction involved only common stock of the company. In every instance the stock and the certificate representing it was endorsed and surrendered to the company and cancelled by the company, and when it was re-issued a new certificate was prepared and delivered in the ordinary manner of the issuance of original shares of its capital stock to subscribers. Each and every acquisition and each and every re-issuance of stock by petitioner of its stock was for cash and in no instance for anything but cash.

During the tax year in question (1929) petitioner issued shares of its own common stock to the public and received therefor \$286,581.21

more than the acquisition cost of such shares. This amount was reflected in petitioner's surplus account and was carried and treated as a non-taxable item in accordance with the Regulations and Rulings of the Treasury Department in force and effect in the year 1929, and which had been in force and effect, unchanged, since the beginning of income tax regulations, and which remained in force and effect, unchanged, until 1935 (six years after the tax year in question).

In 1935 the Commissioner issued new regulations purporting to change existing regulations in a manner claimed by him to render the instant transactions taxable. By applying retroactively such purported amended regulations to every year not barred by statutory limitations, the Commissioner attempted to hold taxable the instant transaction. On that basis he held that the transactions herein recited were taxable, and asserted a deficiency by applying the corporate income tax rate to the above mentioned amount of \$286,581.21.

Petitioner resisted the assertion of the deficiency on the grounds that upon sound and fundamental principles of law, economy and accounting, the said transactions were, and by their inherent nature had to be, adjustments to the capital structure of the company, and could not by their very nature be income transactions; that the recognition of this principle had by long continued and consistent practice and application become the law of this case; that repeated re-enactments by the Congress of revenue acts (including the Revenue Act of 1928) in light of and in recognition of the many years of continuous application of the principle, is an adoption by Congress of such construction in the re-enacted statute; that all "possible doubts as to the proper construction of the language used should be resolved in the light of its administrative and legislative history";\* that such long continued interpretation and construction has the force and effect of law and may not be overturned unless it is so plainly wrong that there can be no doubt about it; that if there is a doubt it must be resolved in favor of such long continued recognition of the principle by the Commissioner and by the Congress; that if such doubt exists it must be resolved in favor of the taxpayer under the established doctrine that doubts generally must be so resolved; and further, in the instant case, if any doubt exists, it must be resolved in favor of the instant taxpayer because in this case the burden is cast upon the respondent by operation of law, and respondent has the benefits of no presumptions or inferences as to the correctness of his ruling—for the reason that this is an affirmative issue raised belately by respondent's plea, as to which issue he must assume the burden of proof of correctness without the aid of the inferences or presumptions of correctness.

\*McCaughn v. Hershey Chocolate Co., 283 U. S. 492, 75 L. ed. 1183, 1186-1187.

## III

In its decision the Board of Tax Appeals made Findings of Fact and rendered an Opinion.

In its Findings of Fact the Board found and held the facts to be substantially as recited in paragraph II hereinabove.

In its Opinion the Board held that when in 1929 it reported as non-taxable the results of these transactions, petitioner complied with the Regulations, which provided that "a corporation realizes no gain or loss from the purchase or sale of its own stock," and that this was in accord with the manner in which petitioner had reported similar transactions for 1924 to 1928, inclusive. The Board further held that Treasury Decision 4430 of May 2, 1934 (purporting to amend all regulations back as far as 1924), changed a long standing departmental regulation which had received long continued executive construction, and that during that time there had been repeated re-enactment of successive revenue acts without substantial change; and that the statutory provision defining "gross income" under which this case arises, is contained in sec. 22 of the Revenue Act of 1928, and that the interpretation and administration of that section, in situations like that obtaining in this case, have been uniform under all revenue acts until the promulgation of T. D. 4430, on May 2, 1934.

The Board, in its Opinion, then called attention to the authorities establishing the rule that a regulation, long and consistently followed, particularly when Congress has re-enacted the statute without change, is not to be overturned, since such re-enactment by Congress without change of a statute which has previously received long continued executive construction, is an adoption by Congress of such construction. The Board also pointed to what is termed "another rule" to the effect that if the departmental construction is  
53 obviously or clearly or plainly wrong, the Court will so hold regardless of the long continued practice in administering the act, but that such construction will not be disturbed unless it is obviously, plainly, or clearly wrong.

The Board then concluded that "we must determine whether the amended regulation is consistent with the statute and whether it is reasonable."

The Board further concluded that: "Considering the magnitude and extent of petitioner's operations during the taxable year, it could hardly be denied that it was dealing in its own shares as it might in the shares of another corporation," and observed that if these transactions had been in the shares of another corporation, a taxable gain would have resulted.

The Board then reviewed a number of its previous decisions (beginning with *Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803), holding that where a corporation purchases and sells its own stock for cash no gain or loss results because of the capital nature of such trans-

actions: and then reviewed certain others of its decisions in which the Board applied a different rule to a different principle involved in transactions wherein a corporation realized a profit on the sale of commodities and accepted shares of its own stock as a medium of payment. The Board observed arguendo that, in *Houston Brothers Co.*, 21 B. T. A. 804, it had referred to *Simmons & Hammond Mfg. Co.*, supra, with approval: that in *S. A. Woods Machine Co.*, 21 B. T. A. 818, the Board had rested its decision, in part at least, upon the *Houston* case; that in the *S. A. Woods* case the Board was reversed; that although the *Houston* case was not appealed, the decision therein was criticized by the Appellate Court in the *S. A. Woods* case: and that since the *S. A. Woods* case was reversed, the criticism of the *Houston* case was in effect a reversal of the *Simmons & Hammond* case, because the latter case had been cited with approval in the *Houston* case. From the foregoing the Board concluded that "while no one of the foregoing decisions specifically overruled the doctrine of *Simmons & Hammond Manufacturing Co.*, supra, the decisions are at variance with the principle of the latter case," and that "indirectly, if not directly, *Simmons & Hammond Manufacturing Co.* has been overruled."

The Board proceeded then to find that in the instant case "the various transactions in its own stock were directed toward  
54 remedying a harmful situation among retailers of its products, toward protecting its employees, its trade brands, and its business, and in pursuance of a long established policy of widening its stockholding base," and that "The record establishes that the primary purposes of the corporation in buying and selling its own stock were to get wider stock ownership and to support the market." The Board then concluded that "albeit there is no testimony that the immediate profit motive was present, the reader of this record would be naive indeed who would not observe such a motive interlarded in the entire situation," and concluded further that the question as to whether the stock in petitioner's hands constituted an "asset" which was bought and sold, is largely a matter of intent: and that since the petitioner held its shares in its treasury with the intent of re-issuing them, "the technical status of the stock while in its hands concerns us little."

The Board next concluded that petitioner's "dealings in its own stock do not fall within the category of capital transactions."

The Board finally concluded that the amended regulation is reasonable and consistent with the statute and that the previous long standing regulation was thereby overruled.

Upon the conclusions reached by it the Board held that the transaction in question gave rise to taxable income to petitioner, and accordingly on July 16, 1937, entered a decision and order saying that there is a deficiency in income tax for the year 1929, based upon such additional income.

11

Petitioner, being aggrieved by said findings of fact, opinion, and decision and order of the Board, and being a corporate taxpayer with

principal office and place of business in the City of Winston-Salem, North Carolina, desires a review thereof in accordance with the provisions of the Revenue Act of 1926 and 1932, and in accordance with other pertinent provisions of law, by the United States Circuit Court of Appeals for the Fourth Circuit, within which Circuit is located the principal office and place of business of the petitioner, and within which Circuit is located the office of the Collector of Internal Revenue to whom petitioner made its income tax returns for the year here under consideration.

## V

Petitioner says that in the Decision, Opinion and Order of the Board manifest error occurred and intervened to the prejudice of the petitioner, and petitioner assigns the following errors, and each of them, which, it avers, occurred therein and upon which it relies to reverse the said Decision and Order so rendered and entered by the Board in this cause, to-wit:

1. The Board erred in concluding and deciding that the decision of the instant issue depends upon the determination whether the amended Regulation is reasonable and consistent with the statute.

2. The Board erred in concluding and deciding that if the amendment to the Regulations is reasonable and consistent with the statute, such amendment can overturn a regulation of many year's standing, in light of which long standing regulation, and in contemplation of the long continued uniform construction put upon it by the Department and the Board, Congress has repeatedly reenacted the taxing statutes without change.

3. The Board erred in failing and refusing to decide and hold that possible doubts as to the proper construction of the statutory language used should be resolved in the light of its administrative and legislative history.

4. The Board erred in failing and refusing to decide and hold that the legislative and administrative history of the section in question gave color and substance to the regulations, rulings, decisions and opinions of the Department and of the Board, covering a period of approximately 20 years, and that it erred in failing and refusing to construe the statute in light of such long continued administrative, judicial and legislative history.

5. The Board erred in concluding and deciding that the amended regulation is reasonable and consistent with the statute and for that reason that the long continued administrative, judicial and legislative history should be ignored and overturned, and this in face of repeated and numerous decisions of the Supreme Court to the contrary—such decisions having firmly established the

rule that: (1) such long continued construction shall not be overturned unless obviously, clearly and plainly wrong and totally contrary to law; (2) that if there be merely doubt as to the soundness of such long continued construction, that construction shall be respected and not overruled; and (3) that all possible doubts as to

the proper construction shall be resolved in the light of its administrative and legislative history.

6. The Board erred in failing to find and decide that Regulations 74 (under the 1928 Act) in force and effect in 1929, when the instant transactions occurred, were reasonable and consistent with the statute.

7. The Board erred in concluding and deciding that petitioner's transactions in its own common capital stock were not in the category of capital transactions.

8. The Board erred in concluding and deciding that the status of this stock while in the hands of petitioner is of small concern or moment in this case—in view of the fact that the basic and fundamental reasoning and philosophy underlying the regulations, rulings and decisions, for approximately 20 years, was that the status of such stock was that of treasury stock and that the issuance and sale of treasury stock is a transaction involving the capital structure of the corporation and as such is a capital transaction, and that the proceeds of treasury stock do not result in income to the corporation.

9. The Board erred in concluding and deciding that the status of the said stock in petitioner's possession was largely a matter of intent.

10. The Board erred in concluding and deciding that the immediate profit motive was present in the instant transactions, and especially was such conclusion and decision erroneous in view of the fact that the Board found and set forth facts to the contrary in its "Findings of Fact" and stated in its "Opinion" that "there is no testimony that the immediate profit motive was present". ("Findings of Fact", bot. of par. 4; par. 7; top of par. 8; par. 9; mid. par. 12; mid. par. 14; mid. par. 15; mid. par. 18. "Opinion", 2nd sentence in par. 19; par. 20.)

57 11. The Board erred in concluding and deciding that the immediate profit motive was present and interlarded the entire situation in the instant transaction; for that, the said conclusion and decision is unsupported by any testimony ("Opinion," par. 20) and is contrary to all the testimony in the record of this cause.

12. The Board erred in concluding and deciding that the issue in the instant cause is ruled by the decision in *S. A. Woods Machine Co.*, 57 F. (2d) 635, which said case was decided upon a state of facts and upon a principle unrelated to those of the instant case, since that decision turned upon a principle wholly and clearly apart from the principle involved herein.

13. The Board erred in concluding and deciding that *S. A. Woods Machine Co.*, *supra*, and the other decisions cited in paragraphs 14 and 16 of the "Opinion" are at variance with the principle and decision in *Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803, and the numerous decisions of the Board which follow the latter decision; for that, the *S. A. Woods* case (and the cases which follow it) support only the principle that where a corporation realizes a profit in a transaction which is otherwise taxable, such profit will not go unrecognized as such merely because the medium of payment in such profit transaction

consisted of the stock of the selling corporation; whereas *Simmons & Hammond*, supra, and the cases which follow it support the principle that the acquisition by a corporation of treasury stock for cash and its re-issuance for cash is a capital transaction and not an income transaction; which said last mentioned rule was carefully and repeatedly distinguished and approved in the cases supporting the rule in the *S. A. Woods* case.

14. The Board erred in concluding and deciding that while *Simmons & Hammond Mfg. Co.*, supra, has not been specifically overruled, it has been indirectly overruled by decisions mentioned in the Board's opinion.

15. The Board erred in concluding and deciding that under Treasury Decision 4430 the transactions here in question were taxable transactions.

58 16. The Board erred in concluding and deciding to approve the Commissioner's contention that in the instant transactions the petitioner was "trafficking" in its own stock as it might "traffick" in the shares of another corporation, which said conclusion and decision was not based upon findings of fact to such effect, and was not based upon any evidence in the instant record.

17. The Board erred in concluding and deciding that the construction of the 1928 Act (such construction being announced in a Treasury Decision in 1934 and incorporated in the regulations in 1935 under a subsequent revenue act, and such construction being in conflict with the construction which had obtained under all previous revenue acts) was the only tenable construction which could be placed upon the 1928 Act.

18. The Board erred in concluding and deciding that Treasury Decision 4430 should be applied retroactively to transactions occurring approximately 6 years before its promulgation, which said transactions were made in light of regulations, rulings, opinions, and decisions of the Treasury Department and of the Board of Tax Appeals which were in force and effect at the time such transactions were made.

19. The Board erred in concluding and deciding that Treasury Decision 4430 applies to the transactions here in question or renders such transactions taxable.

20. The Board erred in failing to decide that the transactions in question were capital transactions and not income transactions.

21. The Board erred in failing and refusing to decide for the petitioner.

22. The Board erred in deciding for the respondent.

23. The Board erred in adding to petitioner's taxable net income for 1929 the above mentioned amount of \$286,581.21.

24. The Board erred in entering its decision and order of July 16, 1937, stating that there is a deficiency in income tax for the year 1929 in the amount of \$37,865.62.

59 25. The Board erred in that its opinion and decision are not supported by the evidence but are contrary to the evidence, and are contrary to law.

Wherefore, petitioner prays that the Circuit Court of Appeals for the Fourth Circuit may review the action, decision, and order of the Board of Tax Appeals in this cause, and direct the entry of a decision by the said Board in favor of the petitioner, determining that there is no deficiency in petitioner's income tax for the year 1929 arising upon the transactions which constitute the subject matter of this appeal and that the Clerk of the said Board be directed to transmit and deliver to the Clerk of this Court certified copies of all and every of the documents necessary and material to the presentation and consideration of the foregoing petition for review, as required by the rules of this Court and by statutes made and provided; and for such other and further relief as may to this Court appear proper in the premises.

(s) J. G. KORNER, Jr.,

(s) D. H. BLAIR,

(s) M. A. BRASWELL,

*Attorneys for Petitioner-Appellant,*

*404 Transportation Building, Washington, D. C.*

*[Duly sworn to by S. Clay Williams; jurat omitted in printing.]*

60 In United States Circuit Court of Appeals for the  
Fourth Circuit

[Title omitted.]

*Notice of filing petition for review*

Filed October 12, 1937

To Honorable HERMAN OLIPHANT,

*General Counsel, Treasury Department,*

*Washington, D. C.*

SIR: You are hereby notified that the above named petitioner did on the 12th day of October 1937 file with the Clerk of the United States Board of Tax Appeals of Washington, D. C., a Petition for Review by the United States Circuit Court of Appeals for the Fourth Circuit of the Decision of the Board heretofore rendered in the above entitled case. A copy of the Petition for Review and the assignments of error as filed is hereto attached and served upon you.

J. G. KORNER, Jr.,

D. H. BLAIR,

M. A. BRASWELL,

*Attorneys for Petitioner-Applicant,*

*404 Transportation Building, Washington, D. C.*

Personal service of the above and foregoing notice, together with the copy of the Petition for Review and assignments of error mentioned therein, is hereby acknowledged this 12th day of October 1937.

J. P. WENCHEL,

*Assistant General Counsel,*

*Bureau of Internal Revenue.*

## 61 Before United States Board of Tax Appeals

[Title omitted.]

*Stipulation of facts*

Filed at Hearing April 27, 1936

It is hereby stipulated by and between the above named petitioner and the Commissioner of Internal Revenue, through their respective attorneys, that the following facts are true and that the Board may incorporate the same into its findings of fact, subject to the right of either party to introduce additional evidence not inconsistent herewith.

1. The petitioner, R. J. Reynolds Tobacco Company, is a corporation organized in 1899, under the laws of the State of New Jersey; its principal office and place of business is Winston-Salem, North Carolina. Its Federal income tax return for 1929 was filed with the office of the Collector of Internal Revenue for the District of North Carolina.

2. The petitioner is engaged in the manufacture and sale of tobacco products, including plug, twist, smoking tobacco and cigarettes.

3. There is attached hereto, marked Exhibit A, and made a part hereof, a statement correctly showing in outline form the capital structure of the petitioner during all the years since its organization as a corporation.

4. There was no authorization during 1929 by charter amendment whereby the authorized number, class, or par value of petitioner's shares of stock were increased or decreased. The following represents the total capitalization of R. J. Reynolds Tobacco Company during the year 1929:

62	1,000,000 shares Common stock at \$10.00 par value-----	\$10,000,000
	9,000,000 shares New Class B Common stock at \$10.00 par value-----	90,000,000
	10,000,000 shares outstanding capital stock-----	100,000,000

5. There is attached hereto, marked Exhibit B, and made a part hereof, a photostat copy of a typical certificate of the New Class B Common stock of the petitioner, referred to in paragraph 4 hereof.

6. During the year 1921, the R. J. Reynolds Tobacco Company acquired, for cash in the amount of \$607,200.96, outstanding fully paid up certificates which as the result of subsequently declared stock dividends and subsequently effected split ups came to represent 75,000 shares of New Class B Common Stock of R. J. Reynolds Tobacco Company; and on January 31, 1929, the said company still held the certificates so acquired. In the year 1929 (and after January 31, 1929) the R. J. Reynolds Tobacco Company cancelled certificates so held by it as aforesaid, representing 15,000 shares (of the said 75,000 shares held by it on January 31, 1929, as aforesaid) and issued in lieu thereof new certificates representing 15,000 shares of New Class B Common Stock of R. J. Reynolds Tobacco Company to divers persons who delivered to the R. J. Reynolds Tobacco Company

the sum of \$708,690.00, in cash, in consideration for the issuance to them of the said certificates representing 15,000 shares of New Class B Common Stock of the R. J. Reynolds Tobacco Company. The said certificates representing 15,000 shares of New Class B Common Stock acquired by R. J. Reynolds Tobacco Company in 1921, as set out hereinabove, were so acquired by it for \$121,440.19 in cash.

7. During the year 1929, the R. J. Reynolds Tobacco Company acquired for cash in the amount of \$4,908,966.17, certificates representing 94,500 outstanding fully paid up shares of New Class B Common Stock of R. J. Reynolds Tobacco Company; and later in the said year 1929, the said company cancelled the said certificates represent-

ing the said 94,500 shares, and issued in lieu thereof new certificates representing 94,500 shares of New Class B Common Stock of R. J. Reynolds Tobacco Company to divers persons who delivered to the R. J. Reynolds Tobacco Company, in the said year 1929, the sum of \$4,506,497.00 in cash, in consideration for the issuance to them of the said new certificates representing 94,500 shares of New Class B Common Stock of R. J. Reynolds Tobacco Company.

8. During the year 1929 the R. J. Reynolds Tobacco Company acquired for cash in the amount of \$4,601,807.43 certificates representing 99,500 outstanding fully paid up shares of New Class B Common Stock of R. J. Reynolds Tobacco Company; and later in the said year 1929 the said company cancelled the said certificates representing the said 99,500 shares of New Class B Common Stock of R. J. Reynolds Tobacco Company and issued in lieu thereof new certificates representing 99,500 shares of New Class B Common Stock of R. J. Reynolds Tobacco Company to divers persons who delivered to the R. J. Reynolds Tobacco Company in the said year the sum of \$4,703,608.00 in cash in consideration for the issuance to them of the said new certificates representing 99,500 shares of New Class B Common Stock of R. J. Reynolds Tobacco Company.

9. The transactions referred to in paragraphs 6, 7, and 8, supra, were cash transactions; none of such transactions were made on margin.

10. Throughout the year 1929 the stock books and stock records of R. J. Reynolds Tobacco Company, in which were recorded the number of its capital shares (New Class B Common Stock) issued and outstanding, indicated that the number of such said shares, at all times during the said year 1929, was 9,000,000 shares. From the time of acquisition of the certificates representing shares of R. J. Reynolds Tobacco Company until the time of their cancellation and the issuance of new certificates in lieu thereof, all of which is more specifically set forth in paragraphs 6, 7, and 8, supra, the said certificates were regularly entered and recorded on the balance sheets in the financial statement of the petitioner, as illustrated by the Financial Statement of R. J. Reynolds Tobacco Company for the year 1928, a copy of which is hereto attached and marked Exhibit C and made a part hereof, in which all of such stock on hand at the beginning of the year 1929 was carried under the entry "Investments in

Non-Competitive Companies," and in which all of such stock was entered and carried at the amount of cash for which it was acquired. The said transactions in respect thereof were not entered or recorded in any records of the company as either increasing or reducing the number of the outstanding shares of its capital stock. At the times of the acquisitions by petitioner of certificates representing its capital stock, as set forth hereinabove, the cash of the petitioner was reduced by the amounts of cash expended for their acquisition. Likewise, at the times in 1929 when the said certificates were disposed of, as set forth hereinabove, the cash of the petitioner was increased by the amounts of cash received by the petitioner by reason thereof, as set forth hereinabove.

11. In the year 1921 the R. J. Reynolds Tobacco Company acquired, for cash, certificates representing a number of shares of R. J. Reynolds Tobacco Company New Class B Common Stock, and on January 31, 1929, the said company still held certificates so acquired, representing 75,000 shares of New Class B Common Stock. The said certificates representing the said 75,000 shares had been acquired by the R. J. Reynolds Tobacco Company, as aforesaid, for cash in the amount of \$807,200.96. When in 1929 the R. J. Reynolds Tobacco Company cancelled certificates representing 15,000 shares and issued new certificates representing 15,000 shares, as set out in paragraph 6, supra, the certificates so cancelled, representing 15,000 shares, constituted a portion of the acquisition in 1921, hereinabove set out. As stated in paragraph 6, supra, the acquisition by R. J. Reynolds Tobacco Company of the certificates representing the said 15,000 shares was for cash in the amount of \$121,440.19.

12. During each of the years 1924 to 1928, inclusive, the petitioner, R. J. Reynolds Tobacco Company, reissued, solely for cash, certain shares of its New Class B Common Stock, theretofore acquired solely for cash, in a manner similar to that set out above herein with respect to the year 1929. Such transactions were made under circumstances and for reasons substantially similar to those surrounding the

65 said similar transactions in the year 1929. For the purpose only of showing generally the result of such transactions during each of said years 1924 to 1928, inclusive, and for no other purpose, it is agreed that, in executing its income tax returns for each of such prior years, the petitioner noted in "Schedule L—Reconciliation of Net Income and Analysis of Change in Surplus," and under subtitle (of said Schedule L) entitled "2. Non-taxable income: . . . . (f) Other items of Non-Taxable Income (to be detailed)" under the notation "Profit R. J. R. Stock," or substantially similar notation, the following amounts:

Years	Amounts
1924.....	\$999,335.25
1925.....	601,507.42
1926.....	85,003.70
1927.....	240.83
1928.....	1,271,023.19

The form of the notation in the tax return for each of said years, as referred to above, is illustrated by the notation contained in item "2 (f)" of "Schedule L" of the income tax return for the year 1929, a copy of which is attached hereto, marked "Exhibit D" and made a part hereof.

13. In his examination and audit for the said year 1929, the Commissioner has not heretofore included as taxable income or deductible loss any amount arising out of, or resulting from, the transactions hereinabove recited.

14. It is the intent and desire of the parties hereto to dispose of (by agreement with the approval of the Board of Tax Appeals) all of the issues presented in the petition filed herein on May 4, 1933. In the deficiency letter dated April 2, 1933, from which this appeal was taken, the Commissioner determined that the petitioner realized a taxable profit for 1929 of \$145,475.44 from the liquidation of the Tobacco Foil Company, Richmond, Virginia, and/or Winston-Salem, North Carolina. It is hereby stipulated and agreed that, for the purposes of this appeal, such profit should be reduced to \$71,196.64. It

is further agreed that the net taxable income for 1929, in the amount of \$38,497,056.05, as determined by the Commissioner (in the said deficiency letter) should be reduced by \$74,278.80—being the difference between \$145,475.44 and \$71,196.64, above mentioned; the tax should be recomputed accordingly.

15. By reason of the addition to taxpayer's net taxable income of the amount of \$71,196.64, as set out in paragraph 14 hereinabove, the taxpayer's income tax due thereon to the State of North Carolina amounts to \$2,774.31, and the similar income tax to the State of Virginia amounts to \$16.61, both of which said amounts properly constitute deductions in computing the net taxable income of this taxpayer for purposes of Federal income tax. It is, therefore, stipulated that in the final computation of deficiency in the instant cause, the said amounts of \$2,774.31 and \$16.61 should be allowed as additional deductions from income of this taxpayer; the tax should be recomputed accordingly.

M. A. BRASWELL,  
J. G. KORNER, Jr.,  
*Counsel for Petitioner.*  
HERMAN OLIPHANT,

*General Counsel for Department of the Treasury.*  
*Counsel for the Respondent.*

*Exhibit A to stipulation*

CAPITALIZATION

Resume of Stock Increases.—The original issue of common stock was increased from \$2,100,000 to \$3,600,000 in 1901, to \$5,000,000 in 1902, to \$7,525,000 in 1906, and to \$10,000,000 in October, 1912. On April 2, 1913, \$10,000,000 preferred stock was authorized, which was increased to \$20,000,000 on Nov. 1, 1917. On the latter date an issue

of \$10,000,000 class "B" common (par. \$100) was also created. Under recapitalization plan June 24, 1920, preferred stock was increased to \$50,000,000 and common stock was increased by \$70,000,000 "New Class B" common (par \$25).

61 **Stock Offerings**—Preferred stock was offered to holders of original common stock at par, as follows: \$2,500,000 in November, 1914; \$2,500,000 in February, 1917, and \$5,000,000 in May, 1917. In Nov. 1919, \$10,000,000 preferred was offered to common and Class "B" common holders. Class "B" common stock was offered to holders of old common, at par, \$5,000,000 in February, 1918, and \$3,000,000 in May, 1918.

**New Capital Readjustment Plan.**—On June 24, 1920, the shareholders approved: (1) an increase in the authorized preferred stock from \$20,000,000 to \$50,000,000; (2) creation of \$70,000,000 "New Class B Common Stock," par \$25, with same dividend rights as common; (3) reduction of par value of common stock from \$100 to \$25, the shares to be exchanged on a 4 for 1 basis. The "New Class B Common" shares (\$25 par) exchanged for old "B" common shares (\$100 par) on a 4 for 1 basis.

**Charter Amendment Ratified—Preferred Stock and \$100 Par "B" Stock Eliminated.**—As a result of the redemption at Jan. 1, 1926, of all the outstanding preferred stock, the provision of the company's charter authorizing \$50,000,000 of this stock became obsolete. In addition the provision of the charter authorizing \$10,000,000 of \$100 par B stock was obsolete ever since the company reduced the par value of its B stock to \$25 per share. On April 6, 1926, the stockholders of the company approved the recommendation of the Directors to eliminate from the charter all provisions for stocks not in use. This was accomplished by changing the authorization for preferred stock and \$100 par B stock, amounting together to \$60,000,000, into that amount of \$25 par B stock identical with that then outstanding.

**Two and One-Half for One split-Up of Common and Class "B" Common Approved.**—Dec. 28, 1928, stockholders reduced the par value of common and common "B" shares from \$25 to \$10 per share and approved the split-up of each \$25 par value share into 2½ shares of \$10 par value.

68 **Stock Dividends.**—On Aug. 16, 1920, a stock dividend of 200% in new class "B" common stock was paid on the \$10,000,000 common stock and the \$10,000,000 Class "B" common stock.

On Dec. 2, 1922, a stock dividend of 33⅓% in new Class "B" common stock was paid on the \$10,000,000 common stock and \$50,000,000 new Class "B" stock.

On Jan. 13, 1927, the Board of Directors declared a stock dividend of 25% on the common stock and new class B common stock, payable Feb. 15, 1927, in new Class B common stock at par, to holders of record of company's common and new class B common on Feb. 1, 1927.

**Preferred Stock Retired.**—The entire outstanding 7% cumulative preferred stock was retired at \$120 per share and accrued dividends at Jan. 1, 1926.

## STOCK PROVISIONS

Preferred stock (now retired) had preference as to assets as well as dividends (7% cumulative) and was redeemable at 120 after three years from date issued.

New Class "B" common stock has the same dividend rights and privileges as the old common, except that it has no voting power.

The new Class B shall not be considered under the company's plan providing for participation by officers and employees in certain profits of the company.

*Exhibit C to stipulation*

R. J. REYNOLDS TOBACCO COMPANY, WINSTON-SALEM, N. C.

## FINANCIAL STATEMENT

December 31, 1928

WINSTON-SALEM, N. C., January 14, 1929.

*To the Stockholders of R. J. Reynolds Tobacco Co.:*

69 The Financial Report of your Company at the close of business December 31, 1928, is hereby submitted.

Net Earnings for the year 1928, after deducting all charges and expenses of management, and after making provision for Interest, Taxes (including Federal and State Income Taxes), Depreciation, Advertising, etc.....		\$30, 172, 563. 17
Deduct: Four quarterly dividends of \$1.25 each and one extra dividend of \$1.50 per share.....		28, 000, 000. 00
Balance carried to Undivided Profits.....		4, 172, 563. 17
Add: Undivided Profits, December 31, 1927.....		40, 696, 774. 85
Total Undivided Profits December 31, 1928.....		\$44, 869, 338. 02

## Exhibit C, Financial Statement, December 31, 1928

## ASSETS

Current:			
Cash.....		\$14, 958, 887. 30	
U. S. Treasury Certificates.....		12, 000, 000. 00	
Accounts Receivable (net) for merchandise sold.....		11, 222, 163. 65	
Leaf Tobacco, Supplies, Manufactured Product.....		97, 595, 012. 34	\$135, 776, 053. 29
Other assets:			
Real Estate, Buildings, Machinery, Fixtures.....	\$24, 694, 177. 48		
Less Depreciation, Obsolescence, etc.....	8, 146, 122. 46	16, 548, 055. 02	
70 Investments in Non-Competitive Companies, etc.....		945, 612. 69	
Bills and Notes Receivable.....		211, 305. 10	
Other Accounts Receivable.....		2, 287, 666. 39	
Brands, Trade-Marks, Good Will.....		1. 00	
Prepaid Expenses.....		491, 606. 86	20, 484, 247. 06
			<u>\$156, 260, 300. 35</u>

Exhibit B

6211959

100

NEW CLASS B COMMON STOCK

NEW CLASS B COMMON STOCK

# R. J. Reynolds Tobacco Company

INCORPORATED UNDER THE LAWS OF THE STATE OF NEW JERSEY

This Certifies that

is the owner of

ONE HUNDRED

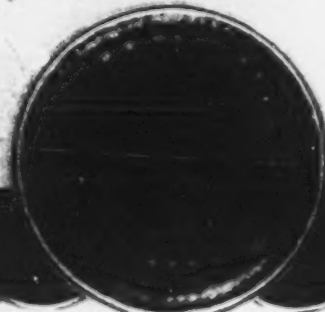
FULL PAID AND NON-ASSESSABLE SHARES OF THE PAR VALUE OF TEN DOLLARS EACH OF THE NEW CLASS B COMMON STOCK OF

R. J. REYNOLDS TOBACCO COMPANY,

transferrable on the books of the company in person or by duly authorized officers or agents of the company, properly endorsed. The New Class B Common Stock shall have the same rights and privileges as the Common Stock of the company except that it shall not have any voting or dividend rights. It shall be considered under the company's plan providing for participation in profits and capital appreciation. This certificate is not valid until countersigned by the Transfer Agent and registered by the Registrar. Witness the seal of the company and the signatures of its duly authorized officers.

*L. D. here*

*S. Clay Williams*



COUNTERSIGNED  
THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK  
TRANSFER AGENT  
ASSISTANT CASHIER

Notice: The signature to this assignment must correspond with the name as written upon the face of the certificate, in every particular, without alteration or enlargement, or any change whatever.

(80) For value Received..... hereby sell, assign and transfer unto .....

..... Shares  
of the Capital Stock represented by the within Certificate, and do hereby irrevocably constitute and appoint Attorney

to transfer the said stock on the Books of the within-named Company with full power of substitution in the premises.

Dated, .....

In Presence of .....

THIS SPACE MUST NOT BE COVERED IN ANY WAY

## End of D to stimulation

13.	Total Income as Items 8 to 12	
14.	Compensation of Officers (from Item 10)	
15.	Rent of Business Property	
16.	Receipts from Business	
17.	Interest	
18.	Taxes (from Item 11)	
19.	Losses (from Item 11)	
20.	Bad Debts (from Item 11)	
21.	Dividends (from Item 11)	
22.	Depreciation (resulting from allocation, wear and tear, or obsolescence from items 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28, 29, 30, 31, 32, 33, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43, 44, 45, 46, 47, 48, 49, 50, 51, 52, 53, 54, 55, 56, 57, 58, 59, 60, 61, 62, 63, 64, 65, 66, 67, 68, 69, 70, 71, 72, 73, 74, 75, 76, 77, 78, 79, 80, 81, 82, 83, 84, 85, 86, 87, 88, 89, 90, 91, 92, 93, 94, 95, 96, 97, 98, 99, 100)	
23.	Depreciation of Mines, Oil and Gas Wells, Timber, etc.	
24.	Other Deductions Not Reported Above (State item and attach statement)	
25.	Net Long-Term Capital Gain	
26.	Net Short-Term Capital Gain	
27.	Net Capital Gain	
28.	Total Excess as Item 13, 25, 27	
29.	Net Income (from Item 13, 25, 27, 28)	
30.	Net Income (from Item 13, 25, 27, 28)	
31.	Less: Income Tax Paid	
32.	Income Tax Paid to a Foreign Country or U.S. possession by a domestic corporation	
33.	Balance of Tax (Item 29 minus Items 31 and 32)	

34. Total Tax (Item 33 plus Item 28)

35. Total Tax (Item 33 plus Item 28)

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100. Total Tax (Item 33 plus Item 28)

An amended return must be marked "Amended" at top of return.

Checks and drafts will be accepted only

### Remarks

# 

[illegible]

3. Concerns whose business involves activity falling in two or more of the above/are identified claims, where the issue posed is conceptual, should report *concerns* as identified with but one of the above general classes; for example, *concerns* in A or B will also transport and market their own product exclusively or mainly, should also be identified with classes A or B; *concerns* in C (manufacturing) or D (retailing) which own or control their source of material supply in A or B and also transport, sell, or market their own product exclusively or mainly, should be identified with manufacturing; *concerns* in D may control or even the source of supply of materials used exclusively or mainly in their manufacturing work; *concerns* in E1 or E2 may own or control the source of their materials or power; *concerns* in F may transport or store their own merchandise, but the production would identify them with A, B, or C.

**1. August**

General class (use key letter designation) C - Tobacco Products

**AFFILIATIONS WITH OTHER CORPORATIONS**

SEE INSTRUCTION 30

4. In this consolidated return of two or more corporations.<sup>1</sup> If an amount from the Collector of Internal Revenue for your district Form 55, Affiliations Schedule, which should be filled in, is not to, and filed as a part of this return. See Article 17 (c) and 18, Regulations 75

8. Did the corporation file a consolidated return for the preceding taxable year? ☐ Yes ☐ No

0-1000000

Upon each check were my name, where I worked or attended school, and my address. "If the answer is 'yes,'" during business hours of all businesses and during off-hours of other businesses, they are provided.

## RESULTS AND DISCUSSION

7. In this return make on the basis of actual receipts and disbursements. If not, describe fully what other basis or method was used in computing the income.

## VALIDATION OF INVENTORIES

8. State whether the inventories at the beginning and end of the taxable year were valued at cost, or cost or market, whichever is lower. If other basis was used, describe fully. State why used and the date inventory was last recomputed.

**LIST OF ATTACHED SCHOOLS IN**

On the other hand, a list of all individuals accompanying this return, giving for each a last name, first name and address of the corporation, together with the individual's name, title and the individual number should be placed on each separate schedule accompanying the return.

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The corporation's books are in care of  
Located at

GENERAL INFORMATION		FINANCIAL DATA		OPERATIONAL DATA	
Item	Description	Amount	Unit	Quantity	Value
1	...	12,771,266.40			
2	...	25,072,008.61			
3	...	25,072,008.61			
4	...	25,072,008.61			
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73	...	25,072,008.61	</		

short period at the beginning of the year 1928, the tobacco market was moving slightly downward. This was followed by an upward movement of about two months and then was followed by a substantial movement downward. The effect of this price cut is shown by the steep drop at that point. That presented an opportunity for acquiring some stock at a cost low enough to give us a chance to make it attractive to desirable stockholders.

In 1924, no stock was acquired but 21,067 shares of the 1921 acquisition was reissued. In 1925, no stock was acquired but 11,000 shares of the 1921 acquisition was reissued. In 1926, we acquired 21,400 shares under the special circumstances outlined above and in the same year reissued these 21,400 shares. In 1927, no shares were acquired and none were reissued, although we made disposition of the fractional shares which accrued to the company by reason of failure to exercise stock rights. In 1928 we acquired 43,300 shares under the special circumstances outlined above, and reissued all of them in the same year. All of the acquisitions above referred to were for cash and for no other consideration and all of such stock was reissued on receipt of cash and for no other consideration.

During all the years from 1921 through 1928, the company never bought or sold the shares of any other corporation. This is also true as to 1929, except that in that year, the company liquidated a small corporation, the stock of which it had acquired at some time prior to 1917. This was an investment which was disposed of in that year and the company has admitted the tax liability in the transaction of the Tobacco Foil stock. The company has, for a number of years, owned some stock in the Glenn Tobacco Co., none of which stock was ever for sale. With these exceptions the transactions relative to its own stock constitute the only acquisitions or dispositions of stock by this company. The company's charter does not authorize it to deal in tobacco stocks. None of the profit  
92 represented in the liquidation of the Tobacco Foil Co. is involved in the present controversy. The stock of the Glenn Tobacco Co. is an investment which is still owned by the company.

None of the shares of the company's common stock was ever acquired by the company as a medium of payment in any transaction in which the Reynolds Company sold a commodity or an asset at a profit. We were following a policy of getting as much common stock as possible for distribution among employees for cash, along with the policy of handling the new Class B stock. There may have been a possibility that in small amounts some Class B stock may have been exchanged for Class A stock, when Class A stock was disposed of for cash and in no instance for anything except cash. I do not know that any such exchange as that took place. What I mean is that some Class A stock may have been acquired in exchange for B stock and then the Class A stock sold to an employee for cash. But none of such transactions are involved in the year 1929.

## Re-Direct Examination by Respondent-Appellee

The shares owned by the officers and directors of the company were more substantial than the average of all the employees. They were the largest of the holdings of the employee group and they were the owners of substantial blocks of stock. The company's action in 1929 which served to protect the interests of the stockholders of the company necessarily served to protect the officers and directors who were stockholders. Class B was a non-voting stock and always has been. The new Class B stock was also a non-voting stock. Class A stock is a voting stock and is largely owned by the officers and employees of the company. It is true that in 1929 some of the officers and directors held stock which was not fully paid for. These people were not in danger and many of them lent collateral to help weaker employees hold theirs. At the end of 1928 there were 30,000 shares of \$25 par value Class B stock which became, on January 31, 1929, 75,000 shares of \$10 par value Class B stock. This was due to a reorganization split-up of the stock, 2½ shares for one. This constituted a part of the acquisition from United Retail Stores in 1921. The total number of shares of \$10 par Class B stock which was held by the company at December 31, 1929, was 431,925 shares.

\* \* \* \* \*

Copies of each of the following exhibits are attached hereto and made a part hereof:

1. Stipulation of certain material facts, executed by the parties and filed with the Board at the hearing.
2. Exhibit A—Statement of capitalization of petitioner corporation, attached to and made a part of Paragraph 3 of the stipulation of the parties above referred to.
3. Exhibit B—Copy of specimen stock certificate of Class B stock, attached to and made a part of Paragraph 5 of the stipulation of the parties above referred to.
4. Exhibit C—Financial statement of petitioner corporation for the year 1928, attached to and made a part of Paragraph 10 of the stipulation of the parties above referred to.
5. Exhibit D—Schedule L of income tax return of petitioner corporation for the year 1929, attached to and made a part of Paragraph 12 of the stipulation of the parties above referred to.
6. Exhibit E—Financial statement of petitioner corporation for the year 1929.
7. Exhibit No. 3—Copy of the charter of petitioner corporation.

The foregoing is the substance of the testimony adduced at the trial of said proceedings.

J. G. KORNER, Jr.,

D. H. BLAIR,

M. A. BRASWELL,

*Counsel for Petitioner.*

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## LIABILITIES

Current:		
Accounts Payable.....	\$3, 777, 139. 14	
Accrued Taxes and other Accrued Ac- counts.....	5, 762, 683. 75	\$9, 539, 822. 89
Reserves: Contingencies.....		1, 851, 139. 44
Capital account:		
Common Stock.....	10, 000, 000. 00	
New Class B Common Stock.....	90, 000, 000. 00	
Undivided Profits (after deduction of divi- dends payable January 1, 1929).....	44, 869, 338. 02	144, 869, 338. 02
		<hr/> \$156, 280, 300. 35

Respectfully,

R. D. SHORE, *Treasurer.*

We hereby certify that we have examined the books of account and record of R. J. Reynolds Tobacco Company, Winston-Salem, N. C., at December 31, 1928, and it is our opinion that the above statement shows the true financial condition of the Company at the date stated, and that the accompanying Analysis of Undivided Profits Account is correct. Inventories of Leaf Tobacco, Supplies, Manufactured Product, and Investments are valued at cost as in former years. As far as we could ascertain there were no contingent liabilities and we were informed none existed.

ERNST &amp; ERNST.

*Certified Public Accountants.*

77 In United States Circuit Court of Appeals for the Fourth  
Circuit

R. J. REYNOLDS TOBACCO COMPANY, PETITIONER-APPELLANT

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT-APPELLEE

Board of Tax Appeals, Docket #71901

*Condensed statement of evidence*

Filed December 2, 1937

Hearing at Washington, D. C., April 27, 1936.

Above entitled cause came on for hearing on this the 27th day of April 1936, before Honorable ERNEST H. VAN FOSSAN, Member, pursuant to notice thereof, whereupon the following proceedings were had and testimony taken, to-wit:

Petitioner's counsel stated that all the issues presented in the petition had been agreed upon and stipulated and that all those issues have been eliminated from this case; that respondent had, by amended answer, raised a new and affirmative issue which constitutes the only issue remaining in the case; and that under the circumstances the

burden of going forward and sustaining his contentions are upon the respondent.

After statements by counsel for the respective parties had been made, outlining the contentions of the parties, evidence was introduced by the parties as follows:

## EVIDENCE FOR RESPONDENT-APPELLEE

Without objection there was submitted into evidence a stipulation of certain material facts, executed by the parties; which said stipulation was read to the Board at the hearing. Said stipulation appears elsewhere in the instant Transcript of Record on Appeal.

## TESTIMONY FOR RESPONDENT-APPELLEE

S. Clay Williams was called as a witness and, on oath, testified in substance as follows:

My name is S. Clay Williams. I reside in Winston-Salem, N. C., and am Chairman of the Board of Directors of R. J. Reynolds Tobacco Co. I have been continuously with that company since 1917. I was assistant general counsel from 1917 to 1921, and general counsel from 1921 to 1924. In 1924 I became an executive vice-president in addition to being general counsel. In 1931 I became president of the company. I was president until 1934, when I became Chairman of the Board.

I participated in the transaction in 1921 in which the company acquired a block of B stock which it sold in 1929. That stock was acquired in 1921 from United Retail Stores, which company held the stock of United Cigar Stores Company, which was a large distributor of all tobacco products. This stock was acquired at private sale. At that time Reynolds stock was not listed on any exchange. The price at which it was acquired was not substantially different from the price at which it was moving in regular sales, although it was slightly lower due to the size of the block of stock acquired. That was the only reason for the lower price. The certificates were delivered to the company and held by the company until 1929, except such portions as were disposed of in the meantime. The certificates were cancelled and the stock reissued.

Part of the total stock sold in 1929 was sold under options given to certain persons who undertook to effect a distribution thereof. Some other was sold in regular course. The company granted an option on it to some one to buy stock at a certain price and the optionee proceeded to make such disposition as he could and called  
79 for delivery of the stock. The options ran for a short period.

Upon confirmation of these transactions the stock was endorsed in blank by our nominee and delivered to the optionee. We held the stock in the name of a nominee. The nominee held it for us and when we were called upon to make delivery we had our nominee endorse and deliver the stock. So far as the stock books of the company were concerned and speaking from the face of the stock books, there

was nothing to indicate any different handling of these certificates as against any other certificates. We in the executive department did not know these details in all instances. When the company uses some of its cash to take up shares of the company from a stockholder, and holds them and by holding them reduces the dividend requirements of the company at each dividend period, the effect is that the dividends on such stock come to the company, and that money goes out of one pocket and into another. We do not know whether, under the administration of the Bureau, such stock would be held as a matter of law to be a reduction in the capital stock of the company or whether it would be a straight purchase and re-sale. What we actually did was to cancel the certificates and issued new certificates. The certificates stood in the name of our nominee all the time and through the period that they were so held. When we disposed of them they necessarily had to have and did have the endorsement of our nominee. Such endorsements were all in blank. The procedure was that the nominee endorsed them in blank, they came into the possession of the company endorsed in blank, they were cancelled, and new certificates were issued in lieu thereof to the purchaser according to the instructions of the optionee at the time. When dividends were declared on the stock held by the company they were paid to the company.

The stock purchased in 1929 was purchased in the market, the stock having been listed on the Exchange. It was bought through brokers at the market price. I think we made about 27 purchases, which totalled the 94,500 shares. They were acquired in October, November, and were sold on three different days during November and December. If the purchases be broken down into the individual shares shown on the stock books of the company as purchases, the number of such individual purchases would be enormously more, because  
 80 if the market was active and we were actively buying, then on each day there would be many purchases. Both purchases and sales were all made through brokers. In many instances Hutton & Co. was our selling agent. Another account was known as the Kenney Nominee Account. The certificates were endorsed in blank and kept in a depository. Another account was that of Horace E. Whitney, wherein we bought and sold 95,500 shares of outstanding fully paid up stock. Those purchases were made on two different days and the sales were made on two different days. Both purchases and sales moved through brokers, except such as moved under the options, if any did move under options. Such purchases and sales as moved through the market were made at the market. Any stock moving under option by previous agreement would move somewhat below the market for the reason that you can not sell a big block of stock at the price you would ordinarily sell a small block.

The company made report of these 1929 transactions in its tax return on Schedule L, which is a reconciliation statement of net income and analysis of change in surplus. In order for the books to reconcile with the tax return it was, of course, necessary for all the items in question to have appeared in our books, whether or not in the same form as in Schedule L of the return. The entries reflecting these

transactions were entered in our books as cash items. They went to our surplus to be included in a financial statement to the company's stockholders. In the return it was reported under the item or schedule entitled "Non-taxable Income" and "Other Items of Non-taxable Income" in the amount of \$486,581.21, which figure was adjusted by the Commissioner to \$286,581.21. That was by way of reconciling our tax return with our books, and the showing that it was a non-taxable profit was because of the Regulation, and in accordance with our understanding and theory of what it was. The item appears in Schedule L of the tax return as part of the reconciliation of net income and analysis of changes in surplus as between the corporate books of account and net income reported for taxation in the return. The company in 1929 acquired certain shares of its own stock which it did not reissue or dispose of in 1929, and such stock was carried on the company's books as "Investment in non-competitive companies." This 81 account carried the common stocks which the company had acquired for cash in 1929 and which it still had on hand at December 31, 1929, and such stock comprised substantially all of that account. Of the amount of \$19,601,594.77 shown on Exhibit E, \$19,270,690.98 represented Class B stock.

#### Cross-examination by Petitioner

When the company disposed of any of this stock the certificates therefor were surrendered up and cancelled, and new certificates were issued. This was true as to all transactions including those here involved wherein the stock was held in the interim by a nominee or nominees. This was equally true upon acquisition of shares by the company.

The stock which was acquired from United Retail Stores was acquired under a decision made in recognition of a special situation as well as a general company policy. It went back a number of years. In 1912, the company was a youngster, a small corporation composed of a few people, having been originally and for some years owned by one family until other stockholders came in. It was in most vigorous competition with much larger companies. This presented a problem of keeping capitalization up to the point where the company could sustain itself in the expansion of its business, which was growing rapidly, and to keep enough people acquainted with and interested in its stock so as to be able to facilitate its business development. It was Mr. Reynolds' plan to have as many employees as possible take a stockholding interest in the business. The company had gone far by 1918, when it issued additional stock. In 1920 a stock dividend multiplied the stock by three and the surplus was capitalized in order to supply working capital.

In 1918 Class B stock was created. This stock did not have certain profit participation provisions which the original stock had. The result was that we put all our stockholders in possession of additional stock at \$100 par and put into employee-stockholders a stock selling for an amount substantially above the amount they had

paid into the company; and this they could dispose of without interfering with their rights of participating in the profit distribution peculiar to their original stock. In this way we set up a situation

under which new stock might come into the market, while  
82 prior thereto the original stock had been held off the market.

This applied not only to employee-stockholders but to non-employee stockholders as well. With this new stock put on the market at \$100 a share, and with a \$10,000,000 capitalization, it would sell much above the amount paid in for it because of the increased value of the company. This opened up a possibility for the company's management in its problem of how to keep the company properly capitalized and also in the problem as to how to preserve the reputation of the company through the reputation of its stock. We had to keep ourselves in position for necessary expansion and, also, in an industry where competition was so intense and public sentiment so sensitive we had to meet the problem of preserving reputation of the company and of its stock, because the behavior of its stock affected the reputation of the company and affected the attitude of the consumer.

This move on the part of the company soon brought about a serious situation. Soon after this new stock was brought out in 1918, Mr. R. J. Reynolds died in July. He controlled the company. The company had just overcome one handicap by creating the new stock which could be sold without penalty to the stockholders and, upon the death of Mr. Reynolds, was confronted with the situation where his estate would have to sell an enormous block of stock. This was the situation which confronted us. We had a very small list of stockholders. There was a big amount of stock to be sold with no reasonable prospect of absorption. Out of that problem came the recognition that if we were to be safe in the future it would be absolutely necessary to get a broader stockholding base, so that when stock had to be sold for any reason we would have a sufficiently large group at least potentially interested in acquiring the stock, and thereby provide for its absorption.

Another aspect of the problem which compelled recognition was the fact that a large amount of the company's stock was held by non-local interests which were well known in the tobacco industry, such as Duke, Ryan, Widener, the Whitneys, and others who had been carrying a substantial interest. In the face of all these things we recognized, in 1918, the necessity of broadening the stockholding basis so as to avoid the chance, so far as we could avoid it, of  
83 ruining the reputation of the company's stock and injury to the company and its brands, in an industry where the competition was so intense. We recognized that there was a possibility of our stock coming into the hands of unfriendly interests. We realized that the best policy was to get our stock into more hands and into the best possible hands whenever an opportunity arrived, in order to get the greatest possible protection against such situations as these.

That was the policy behind the purchase in 1921. A big block of this stock had come into the hands of United Retail Stores, which controlled United Cigar Stores Co., which was a large distributor of tobacco products all over the country. This was the block of stock which had to be sold by the Reynolds Estate in order to pay inheritance taxes. We were selling our products to the United Cigar Stores Co., a big distributor with probably 2,000 retail outlets. We were selling outright to them and also to thousands of other consumers. It became known that United Retail Stores owned a heavy block of stock in our company. When that information got around among the distributors it naturally aroused suspicion on the part of a good many that the United was possibly dictating the Reynolds' policy and that it might not be in the interest of distributors generally to have the company's policy dictated by one of the big distributors. This suspicion was false, but this did not eliminate the suspicion in the minds of our distributors as to its truth. The United publicized the fact that they owned a substantial block of our stock and this increased the suspicion that they were dictating our policy. This was hurtful to our business. Another suspicion that grew up was that if any one distributor owned so much stock he might be buying cheaper and getting better discounts and terms than others. This was not true, but the fact that it was not true did not protect us from the injury created by the suspicion.

Another situation existed which was a fact and not suspicion. That was that since United Retail Stores was the owner of such a heavy block of stock in our company, on which it received dividends, that company could pay dividends to its stockholders although it operated its business without any profit. This meant that the United could pay its dividend out of the dividends it received from our company. This was not wholesome for our company. The United published the fact that they got enough dividends from Reynolds Company to give  
84 it a nice income independent of its operations and this had a bad effect on us.

That was the picture which was in our minds at that time and through all the years which followed. After the above situation had developed we determined to get that block of stock, if we could, and use it to expand our stockholding list over whatever period of time it might take us and thereby protect ourselves against getting into such a situation again. The acquisition of this stock served two ends. It served to protect the company from a dangerous situation and it afforded an opportunity to put into effect our policy of expanding our stockholding base and prevent a raid on our stock in any way. The foregoing situation was behind our purchase of that stock in 1921.

In 1929 another situation developed. Our stock had been listed on the Exchange in 1922. This listing was another step in the pursuit of our policy of getting a wider stock distribution and a better market protection against an injury to the reputation of the stock. By 1929 it had developed that more than 2,000,000 shares of this stock had gotten into the hands of brokers. That was 23% of the total, and we realized that with that much stock in the hands of brokers the only reasonable

deduction was that it was not stock which had found investment holders but was being held for purposes of trading or speculation. We foresaw that if any disturbance came to the market this was a perfect situation in which this stock might be dropped into the market to the great detriment of the stock's reputation. Since the reputation of the company and the reputation of the company's brands and business were inseparably tied up with the reputation of the stock, we were confronted with a situation that might have very greatly injured the reputation of the stock and of the company and of its business.

In October 1929 the market gave some evidence of dropping. The big drop came late in October. With this situation before us the question was raised anew, as it had been raised when we were confronted with the situation in 1921, as to whether or not we could, under these circumstances, make purchases of our stock in service of that situation. The company had sufficient cash (\$29,000,000 in cash and government securities) and, as was done in 1921, the question was

35 referred to the company's law department as to whether or not, under the circumstances, the company could properly buy some of its stock. Our law department advised, as it had done in 1921, that under the special circumstances the company should adhere to its policy, under existing circumstances, and go forward and buy stock. We went into the market as the stock came down, first early in October and more precipitately later in October, and acquired this stock which was being offered in such volume. The volume of these offerings was caused by the fact that so much of it was in the hands of brokers; fully 23%. Our opinion as to the effect the crash might have on the company and the stock and the stockholders was that if, under the circumstances of the threatened crash and with the crash coming on, if nothing was done to support the market, the reputation of our stock with nearly  $\frac{1}{4}$  of it in brokers' hands, presumably in a speculative position and not held as investment stock, the effect would be to destroy completely the reputation of the stock. The effect would have been that the stock would have sold at a price absurdly below its value and the business prospects of the company, because at that time the company was doing an unprecedented volume of business and was making entirely satisfactory and increasing profits.

At that time we had increased the number of employees who were holding common stock which is sometimes referred to by the nickname of "Class A Stock." Officially it is merely common stock. Under our policy of getting as many employees as possible to become owners of that stock, we had, by 1929, gotten the number of employees holding common stock up to a total of 2,000. Our objective was both to get a wider distribution of the stock and a greater interest on the part of the employees.

Another element presenting possibilities of disaster to the company if its stock were permitted to crash to a value representing only a fraction of its worth was this: Most of the employees, the smaller ones including the men in the factories, clerks and other classifications included in the 2,000, had borrowed quite liberally on their stock.

This was not true to the same extent on the part of the directors and officers; but among the minor employees it was true that they had borrowed, some of them all they could borrow. That presented a possibility of disaster to those men in their personal estates and, on top of that, in their relationship to the company. When you remember that this stock had at that time a book value of about \$16 but had then been selling at 64, you can get some estimate of the contribution the stock gave to the reputation of the company, as well as the good will it had built up for itself and its friends and the morale it gave to the company's staff who had that value in their stock. Immediately before the crash the stock was worth 16 on the books but was selling at four times that on the market. A great deal, if not all, of the money that the employees had been borrowing on their stocks was for the purpose of purchasing company stock. We were, therefore, confronted with the special proposition of the effect of the distress of our stock on the morale of our staff. It not only affected their personal status but also their status with the company. The general reputation of the company and its stock was tied up with this situation. Competition was intensive and has always been so, particularly between the bigger companies in the cigarette business, and our competitors capitalize upon all such things just as they did in 1921.

We felt that if we suffered that situation to run its indicated course we would cause great injury to the reputation of the company's stock and its business, and hurt the company and the owners of its stock. So we decided to buy some of that stock as I have outlined. We gave orders to brokers to acquire such stock for us for cash. Our instructions were to acquire such stock at 50 and for a number of days to take at 50 all stock offered. After we had kept these instructions for a number of days we held the stock at 50 until the panic seemed to be lessening a bit and then we gave orders to scale down the price. Immediately the market dropped to 40. That shows how vicious that market was at that time and how heavy the volume. The period through which we held the price at 50 was about two weeks from October 29 until November 12 or 13. We knew all during that period that the minute we stopped buying at 50 the stock would tumble and that was what we were guarding against. We knew that except for our supporting bid the stock would sell much lower. This is proved by the fact that as soon as we eased our bid of 50 the stock dropped to 40. We knew that except for our bid at 50 the stock would be selling at a much lower price.

Earlier in the year 1929 we had acquired some stock under these circumstances: A high official of the company was considering resigning from the company. He held a block of the common stock. The company wanted to get as much of this stock as possible into the hands of employees by having them invest in the company. This was a settled policy and in furtherance thereof we acquired a number of B common shares so as to have it on hand to exchange with that official for his A stock which we would then distribute to our employees at its cost to us. We therefore acquired on a

favorable market in March 1929 a number of Class B shares so as to have them on hand to exchange for Class A stock if that contingency should develop. This Class A stock we would then have available for distribution to our employees at its cost to us. The resignation did not take place; but that is the explanation for the purchase of 45,000 shares earlier in 1929, which is part of the total of 574,880 purchased in 1929.

The sales of the various lots of stock we had acquired at the different times indicated were carried out in this way: After we had got such stock, for the reasons I have given, we further carried out our policy of getting the stock into what we call "good hands" which means into the hands of investors instead of speculators, and into hands that were in position to be useful to the company and its brands, through their good will to forward its interests; and with the further view of protecting the company against situations like those we had been confronted with before, as I have outlined. So we proceeded to reissue such stock for cash as occasion presented.

In 1922 when our stock was listed on the Exchange, in our effort to widen our stockholding base, we had less than 2,000 stockholders of all classes of stock. The exact number was 1077. It was customary for companies the size of ours to have as many as 50,000. At the time of the market crash in 1929 we had only 9,136 of Class B stockholders. With our acquisitions of stock in the 1929 market panic we were able to distribute this stock so that by 1933 we had 41,000 stockholders and by 1936 we had 52,000. This was one of the things we were driving at in acquiring these blocks of stock. Companies comparable to ours had large stockholding lists. For example: In 1934 American Tobacco Co. had 48,750; Atchison, Topeka & Santa Fe R. R. had 39,000; New York Central had 59,000; Pennsylvania R. R. had 232,000; Southern California Edison had 48,000; Standard Oil Co. (N. J.) had 134,000; General Foods had 60,000; National Dairy Products had 71,000; Baltimore & Ohio had 88,000; Montgomery Ward had 60,000; United States Steel had 191,000; American Telephone & Telegraph had 708,000. I do not claim a comparison is applicable between those large ones.

No sales of stock in 1929 involved any acquisitions of stock between the years 1921 and 1929. Other dispositions were made in the intervening years, as noted in paragraph 12 of the stipulation. All of them were made for the same reasons of policy which was to extend our stockholding base and to preserve the reputation of the company's stock and by that means to preserve the company's reputation. I was general counsel of the company during those years and the question was submitted to my department as to whether these purchases could be made under such a policy, and it was the view of the executives and the law department that since this policy involved the reputation of the company and of the stock, its brands and the general welfare of its stockholders, the company should go forward with this policy and buy such stock. The Company's charter did not authorize the company to deal in stock but it was our opinion that the contemplated

transaction was not a matter of dealing in stock but was a pursuit of a general policy of the company. In the absence of specific authority to do this kind of thing, each situation that resulted in a desire or a question on the part of the executives as to whether or not they should go forward and acquire some of this stock had to be submitted to the law department and a ruling obtained as to whether or not under those particular circumstances the company could, in the absence of an authorization to deal in stock, acquire shares of its stock. This was done in each case that presented any different situation or set of facts from the last one on which the question arose, that is, my department each time made a ruling as to whether, under the particular circumstances of that case, the company could make these transactions in view of the absence of charter authorization.

We acquired 21,000 shares for cash and reissued the same within the year for cash in an amount in excess of the cash we had put out in the acquisition. In every transaction the stock was issued or reissued for cash received into the company's treasury. Whether this 89 was a sale or not, I don't know. We had acquired every such share for cash and we reissued it for cash received. The market shows that in 1924 ten typical tobacco stocks (including our own) had a high market early in that year and then during the first quarter it dropped very substantially. During the second and third quarters there was an upward movement. We took advantage of that upward movement between June and August. People who want to buy stocks will buy them when the market is starting up and they won't buy when the market is flat or working down. So when the market was upward we could market our stock without injury to the reputation of our stock, whereas we would injure it if we tried to distribute it in a weak or downhill market. In such a market every share that was offered would just kick it that much further downhill.

This question of preserving the reputation of the company's stock does not mean solely that you keep it from going up or down. It includes something else. It includes having the stock behave itself in a way that its reputation is not injured by its movements in comparison with the movements of comparable stocks. It means such a behavior as will not hurt the reputation of the stock. If we had put enough stock into the market at one time to hold that stock, even though we did not force it down we would have made it impossible for comparable stocks to run away from it. We did not want our stock run down and we did not want it to lose step with other comparable stocks.

In 1924 we disposed of 21,067 shares of the stock acquired in 1921 from United Retail group. The sales we made in 1925 were from the stock we acquired in 1921 from United Retail Stores. In the early part of 1925 there had been a slight advance and then a steep drop in the market. Then the market started up gradually and kept rising during the rest of the year. All stocks were moving upward. Again we took advantage of this situation to issue additional stock without hurt-

ing the position of our stock on the market or the reputation of the company. We had to go very slowly because, as I explained as to 1924, we had to avoid running our stock down and thereby injuring its reputation.

Special circumstances were involved in the 1926 transactions. In that year there was a purchase as well as *as* a sale of a block of 90 stock. The circumstances were that there was a charter amendment in 1926, and by reason of this amendment the management of the company feared the speculators on the market might start a rumor that petitioner would declare a stock dividend. Such a rumor was unfounded but the management desired to protect the company and its stock against such rumors and thereby to protect the reputation of the stock by keeping it from jumping and precipitantly dropping. Accordingly petitioner purchased a block of its stock for cash and after the rumor had passed these shares were gradually reissued for cash. Thereby the company saved the reputation of its stock in the same manner as previously recited.

In 1927 the only transaction this company had, respecting its stock, consisted of a disposition of certain fractional shares which accrued to it in connection with the issuance of stock rights. These worked out into fractions. Some of the people entitled to these rights failed to exercise them within the time prescribed. In the year 1927 the company made disposition of these rights for cash.

In 1928 the company reduced the price of its cigarettes from \$6.40 to \$6.00 per thousand. Following that reduction a great many holders of our stock began to offer for sale on the market and this greatly multiplied the volume of stock which the market was called upon to absorb. Our stockholders list was even then not large enough to absorb the excessive offers.

In view of that situation, and with the same view of protecting the reputation of the stock of the company and its business and its brands, and with plenty of cash on hand at the time we again undertook to acquire on the market for cash certain shares of our stock, protecting that market against the precipitant fall in price which we thought would result if we did not take that action. After that situation had been taken care of the market steadied itself so that we were able to reissue the stock that we had acquired and save that special situation. That accounts for the item listed in the stipulation as to the year 1928, except that along with that item and accounting for part of it, was a disposition in the year 1928 of 1,250 shares of the stock acquired from United Retail Stores in the year 1921. The two items I have referred to account in full for the figures listed in 91 section 12 of the stipulation regarding the year 1928. A rising market in the latter part of 1928 afforded an opportunity to further widen the stockholding base of the company, for the reason that we had a considerable number of shares on hand at that time. That situation in 1928 presented, as we saw it, a perfect opportunity for the practicing of the policy which we had been pursuing. For a

94 The foregoing has been examined and compared with the transcript by counsel for respondent (appellee) who agrees that it contains the substance of all the testimony given at the hearing of this proceeding and consents to the foregoing as the statement of the evidence herein.

J. P. WENCHEL,  
*Chief Counsel, Bureau of Internal Revenue.*

Approved and ordered filed this 2nd day of December 1937.

ERNEST H. VAN FOSSAN,  
*Member, U. S. Board of Tax Appeals.*

*Respondent's Exhibit E*

U. S. Board of Tax Appeals, Div. 9, Docket 71901

Admitted in Evidence Apr. 27, 1936

R. J. REYNOLDS TOBACCO COMPANY, WINSTON-SALEM, N. C.

FINANCIAL STATEMENT

December 31, 1929

WINSTON-SALEM, N. C., January 14, 1930.

*To the Stockholders of R. J. Reynolds Tobacco Company:*

The Financial Report of your Company, at the close of business December 31, 1929, is hereby submitted.

Net Earnings for the year 1929, after deducting all charges and expenses of management, and after making provision for  
95 Interest, Taxes (including Federal and State Income Taxes), Depreciation, Advertising, etc.----- \$32,210,521.27

Deduct:

Three quarterly dividends of sixty cents each and one quarterly dividend of seventy-five cents per share----- 25,500,000.00

Balance carried to Undivided Profits----- 6,710,521.27

Add: Undivided Profits December 31, 1928----- 44,869,338.02

Total Undivided Profits December 31, 1929----- \$51,579,859.29

Financial Statement, December 31, 1929

ASSETS

Current:

Cash----- \$18,139,801.33

Accounts Receivable (net) for merchandise sold----- 11,426,731.03

Leaf Tobacco, Supplies, Manufactured Product----- 90,965,963.80 \$120,532,496.16

## Other assets:

Real Estate, Buildings, Machinery, Fixtures		\$25,211,769.37	
Deduct Depreciation, Obsolescence, etc.	\$9,118,054.82		
Less fully depreciated property written off during year	1,359,565.07	7,758,489.75	
		17,453,279.62	
Investments in Non-Competitive Companies, etc.		19,601,594.77	
Bills and Notes Receivable		329,918.62	
Other Accounts Receivable		4,637,927.30	
Brands, Trade-Marks, Good Will		1.00	
Prepaid Expenses		581,135.60	\$42,633,856.91
			\$163,186,353.07

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## LIABILITIES

## Current:

Accounts Payable	\$3,783,321.26	
Accrued Taxes and other Accrued Accounts	5,993,649.07	\$9,776,970.33
Reserves: Contingencies		1,829,523.45
Capital Account:		
Common Stock	10,000,000.00	
New Class B Common Stock	90,000,000.00	
Undivided Profits (after deduction of dividends payable January 1, 1930)	51,579,859.29	151,579,859.29
		\$163,186,353.07

Respectfully,

R. D. SHORE, Treasurer.

We hereby certify that we have examined the books of account and record of R. J. Reynolds Tobacco Company, Winston-Salem, N. C., at December 31, 1929, and it is our opinion that the above statement shows the true financial condition of the Company at the date stated, and that the accompanying Analysis of Undivided Profits Account is correct. Inventories of Leaf Tobacco, Supplies, Manufactured Product and Investments are valued at cost as in former years. As far as we could ascertain there were no contingent liabilities and we were informed none existed.

ERNST & ERNST,  
Certified Public Accountants.

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## Petitioner's Exhibit 3

U. S. Board of Tax Appeals, Div. 9, Docket 71901

Admitted in Evidence Apr. 27, 1936

Existing Charter of R. J. Reynolds Tobacco Company, September 28, 1931

Charter as Amended of R. J. Reynolds Tobacco Company

This is to certify that we, R. J. Reynolds, W. N. Reynolds, J. B. Duke, J. B. Cobb, Geo. M. Gales, C. K. Faucette, and D. A. Keller do

hereby associate ourselves into a corporation under and by virtue of the provisions of an Act of the legislature of the State of New Jersey, entitled "An Act Concerning Corporations, Revision of 1896", and the several supplements thereto and acts amendatory thereof, for the purpose hereinafter mentioned, and to that end we do by this, our Certificate, set forth:

First: That the name which we have assumed to designate such corporation, and to be used in its business and dealings, is "R. J. Reynolds Tobacco Company."

Second: The location of the principal office of such corporation in the State of New Jersey, is at No. 765 Broad Street, in the City of Newark, in the County of Essex. The name of the agent  
98 therein, and in charge thereof, upon whom process against such corporation may be served, is J. Bayard Kirkpatrick.

NOTE—The location of the principal office of R. J. Reynolds Tobacco Company, in the State of New Jersey, is now at No. 75 Montgomery Street, Jersey City, N. J. The name of the agent therein and in charge thereof, upon whom process against such corporation may be served is Henry A. Cetjen. This change was duly made on the 17th day of January 1921.

Third: The objects for which this corporation is formed are to cure leaf tobacco and to buy, manufacture and sell tobacco in any and all its forms; and to erect or otherwise acquire, factories and buildings, establish, maintain, and operate factories, warehouses, agencies, and depots for the storing, preparation, cure, and manufacture of its tobacco, and for its sale and distribution, and to transport or cause the same to be transported, as an article of commerce, and to do any and all things incidental to the business of trading and manufacturing aforesaid.

This corporation shall also have power to conduct its business or any portion of it in all other states and territories, colonies and dependencies of the United States of America and Great Britain and Canada and all other foreign countries, to have one or more offices out of the State of New Jersey, and to hold, purchase, lease, mortgage, and convey real and personal property out of the State of New Jersey, as well as in said State.

Fourth: The total amount of the authorized capital stock of the Corporation is One Hundred Forty Million Dollars (\$140,000,000) divided into Fourteen Million (14,000,000) shares of the par value of Ten Dollars (\$10.00) per share, of which total authorized capital stock, One Million (1,000,000) shares amounting at par to Ten Million Dollars (\$10,000,000) shall be Common Stock and Thirteen Million (13,000,000) shares amounting at par to One Hundred Thirty Million Dollars (\$130,000,000) shall be New Class B Common Stock.

99 The One Million (1,000,000) shares of Common Stock of the par value of Ten Dollars (\$10.00) per share shall be reserved and used only for the purpose of substitution for the present outstanding Four Hundred Thousand (400,000) shares of Common Stock of the par value of Twenty-Five Dollars (\$25.00) per share

upon the basis of Two and one-half ( $2\frac{1}{2}$ ) shares of said Common Stock of the par value of Ten Dollars (\$10.00) per share for each outstanding share of said Common Stock of the par value of Twenty-Five Dollars (\$25.00) per share, said exchange to be made at such time and in such manner as the Directors of the Company may determine.

Nine Million (9,000,000) shares of the Thirteen Million (13,000,000) shares of New Class B Common Stock of the par value of Ten Dollars (\$10.00) per share shall be reserved and used only for the purpose of substitution for the outstanding Three Million Six Hundred Thousand (3,600,000) shares of New Class B Common Stock of the par value of Twenty-Five Dollars (\$25.00) per share upon the basis of Two and one-half ( $2\frac{1}{2}$ ) shares of said New Class B Common Stock of the par value of Ten Dollars (\$10.00) per share for each outstanding share of said New Class B Common Stock of the par value of Twenty-Five Dollars (\$25.00) per share, said exchange to be made at such time and in such manner as the Directors of the Company may determine.

The New Class B Common Stock shall have the same rights and privileges as the Common Stock of the Company except that it shall not have any voting power and except further that it shall not be considered under the Company's plan providing for participation by officers and employees in certain profits of the Company.

The amount of capital stock with which the Corporation will commence business is Fifteen Hundred Dollars (\$1,500) of Common Stock.

Fifth: The names and Post-office addresses of the incorporators and the number of shares subscribed for by each, the aggregate of such subscriptions being the amount of Capital Stock with which this Company will commence business, are as follows:

100	Name	Post-office Address	Shares
	B. J. Reynolds,	765 Broad Street, Newark, N. J.	2
	W. N. Reynolds,	765 Broad Street, Newark, N. J.	2
	J. B. Duke,	765 Broad Street, Newark, N. J.	3
	J. B. Cobb,	765 Broad Street, Newark, N. J.	3
	Gen. M. Gales,	765 Broad Street, Newark, N. J.	2
	C. K. Faucette,	765 Broad Street, Newark, N. J.	2
	D. A. Keller,	765 Broad Street, Newark, N. J.	1

Sixth: Meetings of the Board of Directors need not be held in the State of New Jersey, but may be held in such place or places in any other State, or States, as the By-Laws of the Corporation may from time to time provide. The Corporation may, through its Board of Directors, acquire and undertake the whole or any part of the business, property, assets, contracts and liabilities of any person, firm, or corporation, if the same are, in their judgment, useful in the business of this Corporation.

The Board of Directors shall have the power by vote of a majority of all the Directors and without assent or vote of the stockholders, to make, alter, amend and rescind the By-Laws of this Corporation, to fix the amount to be reserved as working capital, and to fix what number of Directors shall constitute a quorum of the Board.

Seventh: The existence of this Corporation shall commence on the date of the filing of this certificate, in the office of the Secretary of State of New Jersey, and shall continue perpetually.

In witness whereof, we have hereunto set our hands and seals the third day of April, A. D., 1899.

R. J. REYNOLDS.	[SEAL]
W. N. REYNOLDS.	[SEAL]
J. B. DUKE.	[SEAL]
J. B. COBB.	[SEAL]
GEO. M. GALES.	[SEAL]
C. K. FAUCETT.	[SEAL]
D. A. KELLER.	[SEAL]

(10c I. R. Stamp Can.)

101 Signed, sealed, and delivered in the presence of S. B. Goodale.

STATE OF NEW YORK,

*City and County of New York, ss:*

Be it remembered, that on this third day of April, eighteen hundred and ninety-nine, before me, S. B. Goodale, a Commissioner of the State of New Jersey, in New York, personally appeared R. J. Reynolds, W. N. Reynolds, J. B. Duke, J. B. Cobb, Geo. M. Gales, C. K. Faucetta, and D. A. Keller, known to me to be the individuals described in, and who executed the foregoing Certificate, and I having first made known to them the contents thereof, they did each acknowledge that they signed, sealed, and delivered the same as their voluntary act and deed.

In witness whereof, I have hereunto set my hand and affixed my official seal this third day of April A. D., 1899.

[SEAL]

S. B. GOODALE,

*Commissioner of New Jersey,*

*Resident in New York.*

(10c I. R. Stamp Can.)

[Endorsed:] "Received in the Clerk's office of the County of Essex on the third day of April A. D., 1899, and recorded in Book 16 of Incorp. Bus. Cos. for said County, page 117, &c. William O. Kueblar, Clerk. Filed April 4, 1899. George Wurts, Secretary of State."

NOTE.—Charter amended February 21, 1906, by increasing  
102 Authorized Capital Stock from \$5,000,000 to \$10,000,000, said increase being 50,000 shares of Common Stock at par value of \$100 each.

Charter amended April 2, 1913, by increasing Authorized Capital Stock from \$10,000,000 to \$20,000,000, said increase being 100,000 shares of 7% Cumulative Preferred Stock at par value of \$100 each.

Charter amended November 26, 1917, by increasing Authorized Capital Stock from \$2,000,000 to \$40,000,000, said increase consisting of 100,000 shares of 7% Cumulative Preferred Stock at par value of \$100.00 each and 100,000 shares of Class B Common Stock at par value of \$100 each.

Charter amended June 24, 1920, by reducing par value of the common stocks from \$100 to \$25 and increasing the Authorized Capital Stock from \$40,000,000 to \$140,000,000, said increase consisting of 200,000 shares of 7% Cumulative Preferred Stock at par value of \$100 each, and 2,800,000 shares of New Class B Common Stock, par value of \$25 each.

Charter amended April 15, 1926, by changing the \$60,000,000 of authorizations of the Certificate of Incorporation for Preferred Stock and Class B Common Stock, \$100 par, into an authorization for 2,400,000 shares of New Class B Common Stock of the par value of \$25.00 per share and identical with the existing New Class B Common Stock of the Company.

Charter amended December 28, 1928, by reducing the par value of Common and New Class B Common Stock from \$25.00 per share to \$10.00 per share.

State of New Jersey, Department of State

I, Thomas A. Mathis, Secretary of State of the State of New Jersey do hereby Certify that the foregoing is a true copy of Certificate of Incorporation of "R. J. Reynolds Tobacco Company," Amended to date

-----and the endorsements thereon, as the same is taken from and compared with the original filed in my office on the Fourth day of April A. D. 1899, and now remaining on file and of record therein.

In testimony whereof, I have hereunto set my hand and affixed my Official Seal at Trenton, this Twenty-ninth day of September A. D. 1931.

[SEAL]

THOMAS A. MATHIS,  
Secretary of State.

In United States Circuit Court of Appeals for the Fourth Circuit

[Title omitted.]

*Præcipe for transcript of record*

Filed December 2, 1937

To B. D. GAMBLE,

*Clerk, United States Board of Tax Appeals:*

SIR: It is requested that you prepare a transcript of the record in this cause, as required by law and the rules of the Board and the rules of the United States Circuit Court of Appeals for the Fourth Circuit, under the appeal heretofore perfected in the above-entitled cause, and include in said transcript the following documents:

1. The docket entries in this proceeding in the Board.
2. The Pleadings in the Board, including:
  - (a) The Petition.
  - 104 (b) The Answer.
  - (c) The Amended Answer filed by respondent.
  - (d) Petitioner's re'ly to Amended Answer.
  - (e) Respondent's Rejoinder to Petitioner's Reply.
3. Stipulation of Facts filed by the parties in the Board, together with exhibits attached thereto, namely, Exhibits A, B, C, and D.
4. Agreed Statement of the Evidence.
5. Respondent's Exhibit E.
6. Petitioner's Exhibit No. 3.
7. Findings of Fact and Opinion of the Board, promulgated April 27, 1937.
8. Decision of the Board entered July 16, 1937.
9. The Petition for Review filed by the petitioner, together with notice of filing thereof and acknowledgment of service thereof by respondent, on October 12, 1937.
10. This Praecept.

J. G. KORNER, Jr.,  
D. H. BLAIR,  
M. A. BRASWELL,

*Attorneys for Petitioner-Appellant.*

Service of above Praecept acknowledged.  
No counter praecipe will be filed.  
This 2d day of December, 1937.

J. P. WENCHEL,  
*Chief Counsel, Bureau of Internal Revenue.*

105 [Clerk's certificate to foregoing transcript omitted in printing.]

107 In United States Circuit Court of Appeals for the Fourth Circuit

No. 4290

R. J. REYNOLDS TOBACCO COMPANY, PETITIONER

*vs.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition to Review the Decision of the United States Board of Tax Appeals

*Docket entries*

December 16, 1937, the transcript of record is filed and the cause docketed.

December 16, 1937, certified copy of order extending to December 20, 1937, the time for transmission and delivery of the record is filed.

Same day, the appearance of J. Kilmer Korner, Jr., David H. Blair and M. A. Braswell is entered for the petitioner.

December 22, 1937, the appearance of J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and Philip M. Clark, Special Attorney, Bureau of Internal Revenue, is entered for the respondent.

108 January 12, 1938 the appearance of James W. Morris, Assistant Attorney General, and Sewall Key, Special Assistant to the Attorney General, is entered for the respondent.

January 13, 1938, twenty-five copies of the printed record are filed.

February 12, 1938, stipulation as to respondent's brief is filed.

March 18, 1938, stipulation as to respondent's brief is filed.

April 2, 1938, the appearance of J. Louis Monarch and Morton K. Rothschild, Special Assistants to the Attorney General, is entered for the respondent.

April 16, 1938, petition of Cravath, de Gersdorff, Swaine & Wood for leave to file a brief as amici curiae filed.

April 16, 1938, order granting leave to Cravath, de Gersdorff, Swaine & Wood to file a brief as amici curiae filed.

#### ARGUMENT OF CAUSE

April 19, 1938 (April term, 1938), cause came on to be heard before Parker and Soper, Circuit Judges, and Way, District Judge, and is argued by counsel and submitted.

109 May 18, 1938, petition of petitioner for leave to file authorities filed.

May 18, 1938, order granting petitioner leave to file two certain opinions issued on May 10, 1938, by the Securities and Exchange Commission and to call to the attention of the Court two further authorities having a bearing on the issue present in this cause filed.

May 31, 1938, motion of petitioner for leave to file authorities filed.

May 31, 1938, order granting leave to petitioner to file a supplemental memorandum calling the Court's attention to the decision of the Ninth Circuit Court of Appeals in the case of Commissioner vs. Wilshire Oil Co., Inc., 96 Fed. (2) 971, filed.

110 In United States Circuit Court of Appeals, Fourth Circuit

No. 4290

R. J. REYNOLDS TOBACCO COMPANY, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition to Review the Decision of the United States Board of Tax Appeals

(Argued April 19, 1938. Decided June 6, 1938)

Before PARKER and SOPER, Circuit Judges, and WAY, District Judge

J. G. Korner, Jr. (D. H. Blair and M. A. Braswell on brief), for Petitioner, and Morton K. Rothschild, Special Assistant to the At-

torney General (James W. Morris, Assistant Attorney General, and J. Louis Monarch, Special Assistant to the Attorney General, on brief), for Respondent. Cravath, DeGersdorff, Swaine & Wood; Wm. D. Whitney, Richard H. Wilmer, and Joseph C. White on brief as amici curiae.

*Opinion*

Filed June 6, 1938

111 **SOPER, Circuit Judge:** The petition in this case seeks a review of a decision of the Board of Tax Appeals wherein a deficiency in income tax of R. J. Reynolds Tobacco Company in the amount of \$37,865.62 for the year 1929 was determined. The determination was based upon a profit of \$286,581.21 realized by the corporation during the year from sales of its own class B common stock and was in conformity with the 1934 amendment of Article 66 of Treasury Regulations 74 relating to the Revenue Act of 1928, 45 Stat. 791. The original regulation which was in force from 1918 to 1934 broadly declared<sup>1</sup> that a corporation realizes no gain or loss from the purchase or sale of its own stock; but the amendment of May 2, 1934,<sup>2</sup> stated

112 that the real nature of the transaction determines the question whether the acquisition or disposition by a corporation of shares of its own stock gives rise to taxable gain or deductible loss; and where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another.

The cause originated in a 60 day notice of deficiency mailed to the taxpayer on April 3, 1933, upon which the taxpayer filed a petition for review with the Board. The matter involved had no relation to the present controversy and was adjusted by agreement; but in 1936 before the agreement was formally filed with the Board, the Commis-

<sup>1</sup> **Sale by Corporation of Its Capital Stock.**—The proceeds from the original sale by a corporation of its shares of capital stock, whether such proceeds are in excess of or less than the par value of the stock issued, constitute the capital of the company. If the stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount is not a loss deductible from gross income. If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the shareholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock. Treasury Regulations 74, Article 66.

<sup>2</sup> **Acquisition or Disposition by a Corporation of Its Own Capital Stock.**—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of applicable statutes. Treasury Regulations 77, Article 66 as amended by T. D. 4430.

113 donor filed an amended answer wherein he set up his present contention as an affirmative issue. The majority of the Board was of the opinion that the broad statement in the original regulation that a corporation realizes no gain or loss from the purchase or sale of its own stock was at variance with section 22 (a)<sup>8</sup> of the Revenue Act of 1928 which defines gross income to include gains, profits, and income derived from sales or dealings in property, or from any source whatever; and that the amended regulation was a correct interpretation of the statute. The evidence showed that the corporation had engaged in the purchase and sale of its own stock, usually to its own profit, on numerous occasions during the period 1921 to 1929, and the Board therefore held that the gain derived from this source in 1929 was taxable.

The taxpayer in this petition for review contends (1) that the regulation in force in 1929 was in harmony with established principles of law and of accountancy and constituted a correct interpretation of section 22 (a) of the Revenue Act of 1928; and (2) that even if this interpretation was open to doubt, it was not so patently wrong as to be without a reasonable basis; and therefore it should be applied to a transaction which occurred in 1929, because it represented the administrative construction uniformly given to the Act from 1918 to 1934, during which period the definition of income was reenacted in succeeding federal revenue acts<sup>9</sup> in substantially the same form as it is found in the Revenue Act of 1918, so that we should infer that the regulation correctly expressed the legislative intent.

The facts, set out in detail in the findings of the Board, 35 B. T. A. 949, may be summarized for our present purposes: The Tobacco Company has been engaged in the manufacture and sale of tobacco products in North Carolina since 1899. The capital structure has been changed from time to time by increases in the capital stock, the issuance of a class of common stock known as Class B, by stock dividends and by the reduction in par value of the common stock. The capital in 1929 was \$100,000,000, consisting of \$10,000,000, of \$10. par common stock and \$90,000,000, of \$10. par Class B common stock. The latter class has no voting power and is not considered in the company's plan for profit sharing by its officers and employees.

114 — The founder and principal stockholder at the beginning was R. J. Reynolds, whose policy was to bring as many employees as possible into the company as shareholders, entitled as such to a special annual distribution based on the profits realized. After 1912 the extension of the business was so rapid that new capital was nec-

<sup>8</sup> Sec. 22. Gross Income. (a) General Definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. 45 Stat. 791, 797.

<sup>9</sup> Sec. 213 (a) of the Revenue Acts of 1918, 1921, 1924, and 1926, 40 Stat. 1057, 42 Stat. 727, 43 Stat. 253, 44 Stat. 9. Sec. 22 (a) of the Revenue Acts of 1928, 1932, and 1934, 45 Stat. 791, 47 Stat. 169, 48 Stat. 680.

essary, but at the same time the management desired to protect the reputation of the company and the behavior of the stock on the market. The Class B common stock was first issued in 1918. In the same year Reynolds died and the sale of a substantial portion of his stock to several stockholders became necessary. In 1921 this stock was finally concentrated in a single corporation that was a large distributor of Reynolds products. Thereby a situation disturbing to other distributors was created, and the management determined to buy the stock and sell it to the public, thus ridding itself of a harmful influence and broadening its stockholding base at one and the same time. Accordingly the stock was bought and as the result of this purchase and certain subsequent transactions the company came into possession of 75,000 shares of Class B common stock which it held until January 31, 1929.

During the years 1921 to 1929 the company availed itself of all opportunities of broadening its stockholding base. The result was that the number of stockholders of all kinds of stock was increased from less than 2,000 in 1922 to 9,136 holders of Class B stock alone in 1929; and this number was increased to 52,000 in 1936.

Portions of the Class B stock that were bought in 1921 were sold as follows: 21,067 shares in 1924 and 11,000 shares in 1925, both on a rising market. In 1926, in order to protect the reputation of the stock and to prevent wide variations in prices that were feared, the taxpayer bought 21,400 shares of its stock and later gradually fed it back into the market. In 1928 the price of cigarettes was 115 reduced and the volume of stock offered for sale by stockholders was greatly increased. In order to protect the stock, the taxpayer bought 43,300 shares and after the market steadied, fed them back, together with 1,240 shares which had been bought in 1921. During each of the years 1924 to 1928, the taxpayer reissued for cash, shares of Class B common stock theretofore acquired for cash, in the manner similar to that set forth below with respect to the year 1929, and for like reasons, and the income tax return for each year showed a substantial profit on the transactions which was carried in the return as non-taxable income.

As has been stated, the taxpayer had 75,000 shares of Class B common stock by January 31, 1929. A certificate for 15,000 shares of this stock was cancelled and new certificates were issued to various persons who paid therefor \$708,690. These shares had been acquired in 1921 at a cost of \$121,440.19. During 1929 the taxpayer also sold 194,000 shares which it had purchased in that year—94,500 shares at \$4,506,497, which had cost \$4,908,966.17, and 99,500 shares at \$4,703,608, which had cost \$4,601,807.43. On December 18, 1929, 23% of the total outstanding shares of Class B common stock were in the hands of brokers subject to trading or speculation and were in a position to do great injury to the taxpayer and its business. At the time of the break in the market in 1929 the company had \$29,000,000 in cash and government securities, and the management determined to use these funds in purchasing the taxpayer's stock offered on the

market during October and November, 1929. By purchasing 90% of its stock thus offered, the taxpayer was able to hold the market price at \$50. As the panic eased, the prices were scaled down to \$40 and \$39. During the year it purchased a total of 574,680 shares of its own stock.

At all times during 1929, the stock books and records of the taxpayer indicated that the number of Class B common stock issued and outstanding was 9,000,000 shares. When shares of this stock were purchased by the company, the certificates were regularly entered on the balance sheets of the financial statement of the taxpayer under the entry "investments in Non Competitive Companies" at the amount of cash for which they were acquired; and they were so carried until the certificates were cancelled and new certificates were issued to purchasers in lieu thereof. The transactions of purchase and sale were not recorded so as to indicate either an increase or a reduction of the number of the outstanding shares. The cash of the taxpayer was reduced by the amounts expended in the purchases, and increased by the amounts received in the sales of the stock. At the close of the taxable year 1929, the taxpayer had on hand 431,929 shares of its Class B common stock; and these shares represented \$19,270,690.98 out of a total of \$19,601,594.77 appearing on the taxpayer's books as investments in non-competitive companies. The taxpayer's income tax return for the year indicated a non-taxable profit from dealings in its own stock of \$436,581.21 which was carried on the books as a cash item in the surplus account in accordance with the taxpayer's understanding of the situation and the Treasury Department regulation in force at the time. It is estimated that the amount of the item should be reduced to \$286,581.21.

During a period of sixteen years from 1918 to 1934, the regulations, rulings, and decisions of the Treasury Department and the decisions of the Board of Tax Appeals supported the interpretation of the statute for which the taxpayer now contends. They were based upon the theory that when a corporation issues shares of its stock for the money or property of another person, or acquires such stock in exchange for its own money or property, there takes place a capital transaction which involves a readjustment of the capital structure, but neither a taxable gain nor a deductible loss. Thus the regulations in force during the period expressly declared that "a corporation realizes no gain or loss from the purchase or sale of its own stock";<sup>1</sup> the rulings and decisions of the Treasury Department were in harmony with this pronouncement; and the Board of Tax Appeals in a leading decision, *Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803

<sup>1</sup> Regulations 45, Arts. 542 and 563, Rev. Act of 1918; Regulations 62, Arts. 543, and 563, Rev. Act of 1921; Regulations 65, Arts. 543 and 563, Rev. Act of 1924; Regulations 66, Arts. 543 and 563, Rev. Act of 1926; Regulations 74, Arts. 66 and 176, Rev. Act of 1928; Regulations 77, Arts. 66 and 176, Rev. Act of 1932; Regulations 33, revised, Article 36 promulgated under the Revenue Acts of September 8, 1916, and October 3, 1917, contained the statement that if treasury stock is resold at a price in excess of its cost upon redemption, such excess shall be returned as income.

<sup>2</sup> Law Opinion 296, 5 C. B. 210; Law Opinion 426, 5 C. B. 210; Law Opinion 1035, 1 C. B. 132, 133; Law Opinion 1035, revised, 3 C. B. 190, 162; A. R. R. 693, 5 C. B. 207; A. R. R. 799, C. B. I-1, 374; A. R. R. 8159, C. B. III-2, 256; I. T. 1198, C. B. I-1, 275; I. T. 1736, C. B. II-2, 274; I. T. 1802, C. B. II-2, 267; Solicitor's Memorandum 2205, C. B. III-2, 244.

(1925), held that a corporation which had 323 shares of stock outstanding experienced no deductible loss in the sale of 94 shares for less than the price at which they had been bought by the corporation a few months before.<sup>9</sup>

118 Writers upon the theory of accounting have given much consideration to the proper method of entering upon the records of a corporation purchases and sales by it of its own stock. It is quite generally said that stock purchased and held as treasury stock without retirement should not be treated as an asset but should be carried in the balance sheet as a reduction of capital or of surplus.<sup>10</sup> But it is freely admitted that the actual practice of many important businesses has been to the contrary;<sup>11</sup> and it has been suggested that the correct accounting for stock held in the treasury may be affected in  
110 a given case by attendant circumstances, as for instance, that the amount involved is small in comparison with the total stock outstanding, or that marketable stock is being temporarily held for resale, as indicating that from a practical standpoint the capital structure is not materially affected. This viewpoint has all along been held by Montgomery.<sup>12</sup>

<sup>9</sup> To the same effect was *Cooperative Furniture Co.*, 2 B. T. A. 165. Similar rulings were made with regard to the purchase or sale by a corporation of its shares although at a price varying from that at which they had been previously issued or purchased by the corporation. *Atlantic Carton Corp.*, 2 B. T. A. 380; *Hutchins Lumber & Storage Co.*, 4 B. T. A. 705; *Liberty Agency Co.*, 5 B. T. A. 778; *J. H. Johnson*, 19 B. T. A. 448, affirmed 58 F. (2d) 58; *American Clear Co.*, 21 B. T. A. 464, affirmed 66 F. (2d) 425; *Century Hotel Co.*, 25 B. T. A. 933, affirmed 67 F. (2d) 642; *Ohio Central Telephone Co.*, 28 B. T. A. 96; and with regard to costs and expenses incurred in an issue of stock. *Emerson Electric Co.*, 3 B. T. A. 932; *Simmons Co.*, 8 B. T. A. 631, affirmed 33 F. (2d) 75; and with regard to partial payments forfeited to the corporation upon default in the payment of the full purchase price of stock. *Illinois Rural Credit Assn.*, 3 B. T. A. 2178; *Inland Finance Co.*, 23 B. T. A. 199, affirmed 63 F. (2d) 886; see also 103 W. 55th St. Inc., 15 B. T. A. 210, affirmed 42 F. (2d) 849.

The Board also applied the rule to the purchase by a corporation of the stock of an affiliated corporation, regarding them as a single entity under the statutes. *Farmers Drovers Natl. Bank*, 5 B. T. A. 570; *Interurban Construction Co.*, 5 B. T. A. 529; *Cuba Trust Co. of N. J.*, 12 B. T. A. 688. Recently similar decisions of the Board have been reversed by the courts on the ground that affiliated corporations are separate entities in law. *Commissioner vs. VapCamp Packing Co.*, 67 F. (2d) 596; *Commissioner vs. General Gas & Elec. Corp.*, 72 F. (2d) 364; *Founders General Corp. vs. Commissioner*, 79 F. (2d) 6. The rule of the Board was also applied in the later cases when the transactions involved a transfer of property as well as stock. *Houston Bros. Co.*, 21 B. T. A. 804, overruled *Pellow Estate Co.*, 12 B. T. A. 1365, and *New Jersey Porcelain Co.*, 15 B. T. A. 1669; *S. A. Woods Machine Co.*, 21 B. T. A. 918. Cf. *Haskell & Barker Car Co.*, 9 B. T. A. 1067; see also *Riggs Natl. Bank*, 17 B. T. A. 615, affirmed 57 F. (2d) 980. The decision of the Board in *S. A. Woods Machine Company* was reversed on appeal as will hereinafter appear.

<sup>10</sup> *George R. Hills on Stated Capital and Treasury Shares*, *Journal of Accountancy*, Vol. 57, Jan. to June 1934, 202, 212, 213; *Dickinson Accountancy Practice and Procedure*, 130; *Patron Accountant's Hand Book*, 931-2, 980-1; *Wildman and Powell, Capital Stock Without Par Value*, 93-4; *Marple, Treasury Stock*, *Journal of Accountancy*, Vol. 57, Jan. to June 1934, 257, 262-3; *Sonley and Pinkerton, Corporation Accounting*, 121; *Kester, Accounting Theory and Practice*, 17.

<sup>11</sup> See the articles by Hills and Marple, *Supra*. On May 10, 1938, the Federal Securities and Exchange Commission ruled that the excess of the proceeds of the sale of reacquired shares of a corporation's own stock over the cost thereof should be accounted for as capital since a transaction of this nature does not result in profit or surplus; and that from an accounting standpoint no distinction should be made between such a transaction and the reacquisition and retirement of such stock together with the subsequent issue of stock of the same class.

<sup>12</sup> *Montgomery, Auditing Theory and Practice*, 4th Ed., 1927, 245, 247. In the 5th Ed., 1934, 409, the author stated: "Proceeds of Sale of Treasury Stock.—When capital stock is donated to a corporation, the proceeds of its subsequent sale are capital. In the author's opinion, provided the laws of the state of incorporation permit, when stock is purchased in the open market and would the profit or loss may be reflected in earned surplus since in such a case there is virtually no difference between dealing in its own stock and in the stock or securities of other corporations. It has been urged that when a corporation purchases part of its stock, it is a capital transaction because its outstanding stock is reduced and its surplus increased or decreased; if stock is purchased below par, surplus is increased; if stock is purchased above par, surplus is reduced. When stock is purchased or acquired for permanent holding or for formal reduction of outstanding issues, it is proper to treat it as a capital transaction; but when a corporation buys a relatively small number, say 100 shares, of its own stock at \$80 a share and immediately

When we come to the decisions of the courts we find support both for the view that treasury stock is in truth not an asset in the hands of a corporation; and also for the opinion that the real nature of the situation must be examined in order to determine whether gain or loss, recognizable by the taxing statutes, has occurred in the purchase or sale by a corporation of its own stock. Thus it was said by Judge Learned Hand in speaking of treasury shares in *Borg vs. International Silver Co.*, 11 F. (2d) 147, 150:

"Such shares are of necessity retired in this sense: That they constitute no longer any liability of the defendant. A corporation can have no right of action against itself, as must be if the share is truly a liability. Indeed the only difference between a share held in the treasury and one retired is that the first may be resold for what it will fetch on the market, while the second has disappeared altogether. \* \* \* To carry the shares as a liability, and as an asset at cost, is certainly a fiction, however admirable. They are not a liability, and on dissolution could not be so treated, because the obligor and obligee are one. They are not a present asset, because, as they stand, the defendant cannot collect upon them. What in fact they are is an opportunity to acquire new assets for the corporate treasury by creating new obligations. In order to indicate this potentiality, it may be the best accounting to carry them as an asset at cost, providing, of course, all other assets are so carried. Even so, a company which revalued its assets might properly carry them at their sale value when the revaluation was made. In any event there can be no ambiguity in stating the facts more directly as the defendant did: that is, in treating the shares as not in existence while held in the treasury, except as a possible source of assets at some future time, when by sale at once they become liabilities and their proceeds assets. It makes no difference whether this satisfies ideal accounting or not."

The holding of the Board in *Commissioner vs. S. A. Woods Machine Co.*, 21 B. T. A. 818, that in accordance with Regulations 65, Article 543, no taxable income resulted when a corporation accepted shares of its own stock in payment of damages due it for patent infringement was reversed in 57 F. (2d) 635. Adopting the realistic view of the problem the court said:

"Whether the acquisition or sale by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction involved. *Walville Lumber Co. vs. Com. of Internal Revenue* (C. C. A.) 35 F. (2d) 445; *Spear & Co. vs. Heiner* (D. C.) 54 F. (2d) 134. If it was in fact a capital transaction, i. e., if the shares were acquired or parted with in connection with a readjustment of the capital structure of the corporation, the Board rule applies. *Doyle vs. Mitchell Bros. Co.*, 247 U. S. 179, 184, 38 S. Ct. 467, 62 L. Ed. 1054; *Eisner*

sells it for \$50 a share, the gain of \$1,000 is no more a capital gain than if the purchase and resale were of any other security or commodity." See also *Sunley and Pinkerton on Corporate Accounting*, 123, 124; *Dickinson, Accountancy Practice and Procedure*, 117; *R. E. Payne on Treasury or Recquired Stock in the Certified Public Accountant* February 1936, Vol. 16, 98-105; *Laquerre, Practical Accounting Problems, Part II*, 1922, 6-81.

vs. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. A. 1570. But where the transaction is not of that character, and a corporation has legally dealt in its own stock as it might in the shares of another corporation, and in so doing has made a gain or suffered a loss, we perceive no sufficient reason why the gain or loss should not be taken into account in computing the taxable income. The view taken by the Board of Tax Appeals (see *Houston Brothers Co. vs. Commissioner*, 21 B. T. A. 804) presses accounting theory too far in disregard of plain facts. It is not supported by any decision which has come to our attention except those of the Board.

The transaction involved in this case was equivalent to the payment of the debt in cash and the investment of the proceeds by the corporation in its own stock. If that had been done clearly the cash received would have been taxable income. The transaction was not changed in its essential character by the fact that, as a debtor happened also to own the stock, the money payment and the purchase of stock were by-passed, and the stock was directly transferred in payment of the debt. The stock was the medium in which the debt was paid. The wide door to evasion of taxes opened by the decision of the Board is an additional reason, and a weighty one, against it."

See also *Commissioner vs. Boca Ceiga Development Co.*, 66 F. (2d) 1104; *Allyne-Zerk Co. vs. Commissioner* (C. C. A. 6), 1936, 83 F. (2d) 525 *Dorsey vs. Commissioner* (C. C. A. 5) 1935, 76 F. (2d) 339, *cer. den.* 296 U. S. 589; *Burnett vs. Riggs Natl. Bank* (C. C. A. 4), 1932, 57 F. (2d) 980. See also the comment on *Taxability of Transactions by a Corporation in Its Own Stock*, 47 Yale L. J. 111.

It is manifest that the decision of the court in *Commissioner vs. S. A. Woods Machine Co.*, *supra*, led to the promulgation of the amended regulation by the Secretary of the Treasury which now appears as Regulations 77, Article 66, wherein the Board revised its former position and adopted the view that "whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction which is to be ascertained from all its facts and circumstances; \* \* \*" and "where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another."<sup>13</sup>

Enough has been said to suggest that neither interpretation of the Act is without a reasonable basis. On the one hand, it is reasonable to say that when a corporation buys or sells its own stock, a change in its capital structure takes place; and that the change may be of material significance although purchases are followed by sales, if substantial

<sup>13</sup> The change had perhaps been foreshadowed in *Houston Brothers Co. vs. Commissioner*, 21 B. T. A. 804, 815, upon which the conclusion reached by the Board on the same day in *S. A. Woods Machine Company*, *supra*, was based, when the Board expressly declined to decide what rule should be applied in the case of a casual purchase and sale in the open market by a corporation of its own shares, nothing more being intended or accomplished than a temporary holding of the stock.

amounts of stock are involved and the stock is held in the treasury for substantial periods of time. On the other hand it may be said that the increase or decrease of net resources which often accompanies the purchase and sale of marketable stock bears strong resemblance to the gain or loss which the taxing statutes recognize; and this appears to be the more manifest when the change in the amount of outstanding stock is relatively small and the period during which it is held by the corporation as treasury stock is short. There is room for debate, and this situation determines the rationale of our decision in the pending case.

We do not undertake to say that the present regulation would not have been a correct interpretation of the statute, as applied to such facts as are now before us, if it had been promulgated in 1918.

123 But, as we have seen, the prevailing opinion in that year and thence continuously until 1934 forbade the taxation of such a profit as the Tobacco Company earned in 1929 in the sale of its own stock; and Congress in the light of this interpretation of its intent reenacted in substantially the same words the definition of income subject to tax in five successive carefully considered revenue acts. Our path is therefore clear; for the rule is well settled that if a statute is reasonably susceptible of two constructions, its reenactment after an interpretative ruling by responsible officials amounts to a legislative sanction of the course pursued. Especially is this true when the construction has been long maintained and several reenactments of the language in dispute have taken place. The rule has been frequently applied in cases under the revenue acts when the statutory language is in general terms and susceptible of different interpretation as applied to the relevant facts; and in *Johnson vs. Commissioner*, 56 F. (2d) 58 (C. C. A. 5), 1932, it was applied to the very regulation now under consideration as set out in Regulations 62, Article 543 relating to the Revenue Act of 1921. See also *United States vs. Alabama, Great Southern Ry. Co.*, 142 U. S. 615; *Copper Queen Const. Mining Co. vs. Arizona*, 206 U. S. 474; *United States vs. Cerecedo*, 209 U. S. 337; *Brewster vs. Gage*, 280 U. S. 327; *McFeeley vs. Helvering*, 296 U. S. 102; *Helvering vs. Richmond, F. & P. R. Co.*, 90 F. (2d) 971.

In *Mass. Mutual Life Ins. Co. vs. United States*, 288 U. S. 269, 273, the court said:

"The Congress in the Revenue Acts of 1928 and 1932 reenacted Section 245 without alteration. This action was taken with knowledge of the construction placed upon the section by the official charged with its administration. If the legislative body had considered the Treasury interpretation erroneous it would have amended the section. Its failure so to do requires the conclusion that the regulation was not inconsistent with the intent of the statute (*National Lead Co. vs.*

*United States*, 252 U. S. 140, 146; *Poe vs. Seaborn*, 282 U. S. 101, 116; *McCaughn vs. Hershey Chocolate Co.*, 283 U. S. 488, 492; *Costanzo vs. Tillinghast*, 287 U. S. 341) unless, perhaps, the language of the act is unambiguous and the regulation clearly inconsistent with it. Compare *Louisville & N. R. Co. vs. United States*, 282 U. S. 740, 757-8." Cf. *Manhattan vs. Commissioner*, 297 U. S. 129;

135; Koshland vs. Helvering, 298 U. S. 441, 446; Burnet vs. S. & L. Bldg. Corp., 288 U. S. 406; Murphy Oil Co. vs. Burnet, 287 U. S. 397; Helvering vs. Safe Deposit & Trust Co., Executor of Will of Henry Walter (C. C. A. 4), 95 F. (2d) 806.

The decision of the Board of Tax Appeals is reversed.

126 In United States Circuit Court of Appeals, Fourth Circuit

No. 4290

R. J. REYNOLDS TOBACCO COMPANY, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

*Judgment*

Filed and Entered June 6, 1938

On petition to Review the Decision of the United States Board of Tax Appeals

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the decision of the said Board of Tax Appeals, in this cause, be, and the same is hereby, reversed; and that this cause be, and the same is hereby, remanded to the United States Board of Tax Appeals for further proceedings in accordance with the opinion of the Court filed herein.

June 6, 1938.

MORRIS A. SOFFER,

*U. S. Circuit Judge.*

127 On another day, to-wit, July 7, 1938, the mandate of this Court, in this cause, is issued and transmitted to the United States Board of Tax Appeals at Washington, D. C., in due form.

[Clerk's certificate to foregoing transcript omitted in printing.]

128 Supreme Court of the United States

*Order allowing certiorari*

Filed October 17, 1938

The petition herein for writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice STONE took no part in the consideration and decision of this application.

[Endorsement on cover:] File No. 42,813. U. S. Circuit Court of Appeals, Fourth Circuit. Term No. 328. Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, vs. R. J. Reynolds Tobacco Company. Petition for a writ of certiorari and exhibit thereto. Filed September 6, 1938. Term No. 328 O. T. 1938.

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# **In the Supreme Court of the United States**

OCTOBER TERM, 1938

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No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL  
REVENUE, PETITIONER

v.

R. J. REYNOLDS TOBACCO COMPANY

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## **PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT**

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fourth Circuit entered in the above-entitled cause on June 6, 1938, reversing a decision of the Board of Tax Appeals.

### **OPINIONS BELOW**

The opinion of the Board of Tax Appeals (R. 21) is reported in 35 B. T. A. 949. The opinion of the Circuit Court of Appeals (R. 108) is reported in 97 F. (2d) 302.

**JURISDICTION**

The judgment of the Circuit Court of Appeals was entered on June 6, 1938 (R. 116). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

**QUESTION PRESENTED**

After the taxpayer, a corporation, had originally issued its stock, it traded in its own stock on the open market, buying for cash and selling for cash, without any intention or authority to increase or decrease its authorized capital. During 1929, the taxable year, the taxpayer derived a gain from such trading in its own stock. However, the applicable Treasury regulations, Article 66 of Treasury Regulations 74, provided in part that a corporation realizes no gain or loss from the purchase or sale of its own stock. Subsequently the applicable Treasury regulations were amended by Treasury Decision 4430 to provide that where a corporation deals in its own stock as it might in the shares of another corporation the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. The question presented is whether this case is properly governed by the rule set forth in the original or in the amended regulation.

**STATUTE AND OTHER AUTHORITIES INVOLVED**

The statute and other authorities involved will be found in the Appendix, *infra*, pp. 26-29.

## STATEMENT

The facts, as found by the Board of Tax Appeals (R. 22-30), are substantially as follows:

The taxpayer is a corporation organized in 1899 under the laws of the State of New Jersey. Its principal office and place of business is Winston-Salem, North Carolina. It is engaged in the manufacture and sale of tobacco products, including plug, twist, smoking tobacco, and cigarettes (R. 22).

From time to time since 1901 the capital structure of the corporation has been changed by increases in the common stock by the issuance of new classes of common stock known as class B common, later eliminated in favor of new class B common; by the issuance and subsequent retirement of preferred stock; by stock dividends; and by stock split-ups due to reduction in the par value of the common stock (R. 22-23). During the taxable year 1929 the total capitalization of R. J. Reynolds Tobacco Company was (R. 23):

1,000,000 shares common stock at \$10 par value.....	\$10,000,000
9,000,000 shares new class B common stock at \$10 par value.....	90,000,000
10,000,000 shares outstanding capital stock.....	100,000,000

The principal difference between common stock and new class B common is that the latter had no voting power and was not considered under the company's plan providing for participation by officers and employees in certain profits of the company. There was no authorization during the tax-

able year by charter amendment whereby the authorized number, class, or par value of taxpayer's shares of stock was increased or decreased (R. 23).

In 1912 the taxpayer was young in the tobacco industry, being a very small corporation whose stock was owned by one family until other stockholders were brought in from time to time. Its principal stockholder and founder was R. J. Reynolds, whose practice it was to bring as many employees as possible into the company as stockholders. Under the by-laws of the company the holders of the only stock then outstanding were entitled to a special distribution each year based on the profits realized, and as a result the owners of this class of stock retained their holdings in order to participate in the profits (R. 23).

At 1912 taxpayer was in vigorous competition with three other tobacco companies, each having many times the capital of taxpayer. After 1912 taxpayer's growth was rapid. Its business prospered to such an extent that maintaining the capitalization of the company at a point where it could support the rapid expansion of the business, and meet competitive conditions, presented a serious problem. At the same time the management of the taxpayer desired to preserve (1) the reputation of the company, (2) the reputation of the stock, and (3) the behavior of the stock on the market, including its behavior in comparison with other similar stocks (R. 23).

In 1918 the taxpayer created the class B common stock which did not participate in the special dis-

tribution based on the company's profits, and which was, therefore, available on the open market. Later this class B stock was eliminated by charter amendment in April 1926 (R. 23-24).

In July 1918 R. J. Reynolds, taxpayer's largest stockholder, died. It became necessary for his estate to sell a substantial portion of the stock in order to pay the inheritance taxes on his estate. This stock was purchased by several individuals, but subsequently, and prior to 1921 it was finally concentrated in the single ownership of United Retail Stores, which controlled United Cigar Stores Company, a large distributor of taxpayer's tobacco products. United Retail Stores publicized the fact that it owned a substantial block of taxpayer's stock. Rumors developed and the suspicion grew that United Retail Stores was dictating taxpayer's business policies and was able to buy taxpayer's tobacco products at lower prices and for better discount than other distributors and retailers. Furthermore, the dividends regularly paid by the taxpayer made it possible for United Retail Stores to operate its approximately 2,000 retail stores without profit, and yet have a substantial amount with which to pay dividends to its own stockholders (R. 24).

It was the judgment of taxpayer's management that the reputation of the company and the necessity of protecting its business required the purchase of this United Retail Stores stock. Taxpayer had recognized in 1918 the necessity of broad-

ening its stockholding base, and the acquisition of this block of stock afforded taxpayer an opportunity to remove a harmful situation and at the same time permitted taxpayer to expand its stockholding list by feeding the stock back onto the market. The law department of the taxpayer considered and ruled that taxpayer was authorized to make the 1921 purchase, and the other purchases herein-after related, and reissue the stock, although taxpayer had no charter authority to deal in its own stocks (R. 24).

For the reasons aforementioned the taxpayer purchased during 1921 the block of old class B common stock held by United Retail Stores, the number of shares purchased being undisclosed. The purchase was made at a private sale, the stock in question not being listed on any exchange in 1921. The consideration paid was \$607,200.96 in cash, which was slightly under the market price by reason of the amount of stock involved. As a result of subsequently effected stock split-ups and stock dividends that portion of this purchase here involved came to represent 75,000 shares of new class B common stock, the certificates therefor being held by taxpayer on January 31, 1929 (R. 24-25).

During all the years 1921 to 1929, inclusive, and thereafter, the taxpayer followed the same general policy of availing itself of all opportunities that were presented for extending its stockholding base. The effectiveness of this general policy is revealed by the increase in the number of taxpayer's stock-

holders over a period of years. In March 1922, when taxpayer's stock was listed on the New York Stock Exchange, taxpayer had less than 2,000 stockholders, counting common stock and class B common stock. At the time of the market crash in 1929 there were 9,136 shareholders of B stock alone. In 1933 there were 41,000 stockholders and in April 1936 there were 52,000 holders of B stock (R. 25).

In 1924 taxpayer sold for cash 21,067 shares of the stock purchased in 1921 from United Retail Stores. The sales were made in the second and third quarters of 1924 on a rising market, following a substantial drop of the market in the first quarter (R. 25).

In 1925 the taxpayer sold for cash 11,000 shares of the stock purchased in 1921 from United Retail Stores. These shares were sold or reissued between February 10 and August 13, 1925. The management took advantage of a rising market to dispose of these shares without hurting its stock or the reputation of the taxpayer (R. 25).

By reason of a charter amendment in 1926 the management of taxpayer feared that speculators on the market might start a rumor that taxpayer would declare a stock dividend. To protect the reputation of the stock, which included keeping it from jumping and precipitately dropping, the taxpayer purchased through a broker for cash 21,400 shares of its stock. After fear of the rumor had passed the 21,400 shares were gradually fed back into the market (R. 25).

In 1927 the taxpayer's only transaction respecting its own stocks was the disposition of certain fractional shares accumulated in its hands in connection with the issuance of rights to subscribe or receive additional stock. These fractional shares, which had cost taxpayer nothing, were disposed of for cash in the amount of \$240.83 (R. 25-26).

During April 1928 taxpayer reduced the of its cigarettes from \$6.40 to \$6 per tho Following this reduction the volume of taxpayer's stock offered on the market was greatly multiplied. Taxpayer, with a view to protecting the reputation of the stock of the company, its business, and its brands, purchased for cash 43,300 shares of its stock, expecting thereby to protect the market against a precipitate fall in prices. After the market steadied the 43,300 shares were fed back into the market, together with 1,240 shares of the stock acquired from United Retail Stores in 1921 (R. 26).

During each of the aforesaid years 1924 to 1928, inclusive, the taxpayer, R. J. Reynolds Tobacco Company, reissued solely for cash certain shares of its new class B common stock, theretofore acquired solely for cash, in a manner similar to that hereinafter set forth with respect to the taxable year 1929. Such transactions were made under circumstances and for reasons substantially similar to those surrounding the said similar transactions in the year 1929. For the purpose only of showing generally the result of such transactions during each of said years 1924 to 1928, inclusive,

and for no other purpose, the parties below agreed that, in executing its income tax return for each of such prior years, the taxpayer noted in "Schedule L—Reconciliation of Net Income and Analysis of Change in Surplus" and under subtitle (of said schedule L) entitled "2. Non-taxable income \* \* \* (f) Other Items of Non-Taxable Income (to be detailed)" under the notation "Profit R. J. R. Stock", of substantially similar notation, the following amounts (R. 26):

<i>Years</i>	<i>Amounts</i>
1924.....	\$999,335.25
1925.....	601,507.42
1926.....	85,003.70
1927.....	240.83
1928.....	1,271,023.19

At the close of 1928 taxpayer had 30,000 shares of its new class B common stock, which became 75,000 shares by January 31, 1929, due to a 2½ for 1 split-up approved by the stockholders on December 28, 1928, thus reducing the par value of the stock from \$25 per share to \$10 per share (R. 26-27).

Subsequent to January 31, 1929, the taxpayer canceled certificates representing 15,000 shares of said 75,000 shares and issued in lieu thereof new certificates representing 15,000 shares of new class B common stock to divers persons who delivered to taxpayer the sum of \$708,690 in cash for said 15,000 shares. The 15,000 shares so disposed of by taxpayer were acquired as a part of taxpayer's 1921 purchase at a cost to taxpayer of \$121,440.19 in cash (R. 27).

On December 18, 1929, 2,106,139 shares, or more than 23 percent of the total outstanding 9,000,000 shares of taxpayer's new class B common stock, were in the hands of brokers, subject to trading or speculation. This stock was in a position to do great injury to taxpayer, its stock, and its products. Approximately 2,000 employees of taxpayer held shares of its stock and many of them had borrowed heavily on their stock. With the then market price of approximately 64, a heavy drop in the market would have been disastrous to many of taxpayer's employees (R. 27).

At the time of the market break in 1929 taxpayer had \$29,000,000 in cash and Government securities, which the management determined to and did use in purchasing the taxpayer's stock offered on the market during the break in October and November 1929. During the height of the stock market panic, from approximately October 29 to November 13, 1929, taxpayer held the market price of its stock at 50, purchasing 90 per cent of its stock offered on the market. As the panic eased, taxpayer's purchases were scaled down to 40 and 39. During the taxable year 1929 taxpayer purchased a total of 574,880 shares of its own stock (R. 27).

In addition to selling the 15,000 shares aforementioned during 1929, taxpayer sold 194,000 other shares of the new class B common stock it had purchased in 1929. One block representing 94,500 shares of new class B common stock was acquired by taxpayer for cash in the amount of \$4,908,966.17. Later in 1929 taxpayer canceled the

certificates representing these 94,500 shares, issuing new class B common stock certificates in lieu thereof to divers persons for \$4,506,497 in cash. Another block of 99,500 shares of new class B common stock was acquired by taxpayer in 1929 for \$4,601,807.43 in cash. Later in 1929 taxpayer canceled the certificates representing these 99,500 shares, issuing new class B common stock certificates in lieu thereof to divers persons for \$4,703,608 in cash. The transactions covering the said 94,500 and 99,500 share blocks of stock were handled by brokers on the New York Stock Exchange (R. 27-28).

At all times during 1929 the stock books and records of the taxpayer indicated that the number of its new class B common stock issued and outstanding was 9,000,000 shares. From the time of acquisition of the certificates representing shares of taxpayer's stock until the time of their cancellation and the issuance of new certificates in lieu thereof, the said certificates were regularly entered and recorded on the balance sheets in the financial statement of taxpayer under the entry "Investments in Non-competitive Companies", in which all of such stock was entered and carried at the amount of cash for which it was acquired. The said transactions in respect thereof were not entered or recorded in any records of taxpayer as either increasing or reducing the number of the outstanding shares of its capital stock. At the

times of the acquisitions by taxpayer of certificates representing its capital stock, as set forth hereinabove, the cash of taxpayer was reduced by the amounts of cash expended for their acquisition. Likewise, at the times in 1929 when the said certificates were disposed of, the cash of taxpayer was increased by the amounts received from the disposition thereof (R. 28).

At the close of the taxable year the taxpayer had on hand 431,925 shares of its new class B common stock. As of December 31, 1929, these shares represented \$19,270,690.98 out of the \$19,601,594.77 total appearing on taxpayer's books in the amount designated "Investments in Non-competitive Companies". The balance of the account represented investments in the stock of two small licorice companies (from which taxpayer secured its supplies of licorice), and stock in the Glenn Tobacco Company. None of the shares of stock of the last mentioned three companies was for sale or was traded in by taxpayer (R. 28).

The profit from the sale by taxpayer of its own shares of stock arose solely through the sale of new class B common stock. The stock certificates covering the shares sold in 1929 were endorsed, surrendered, canceled, and reissued in the same normal manner as sales and purchases of all of taxpayer's shares of stock. Each transaction involved herein was a completed and closed transaction in the taxable year 1929. During 1929 each and every acqui-

sition and each and every sale made by taxpayer of its own stock was for cash and in no instance for anything except cash (R. 28-29).

Taxpayer's 1929 income tax return, schedule L, indicates a nontaxable profit of \$436,581.21. It was stipulated that the last mentioned figure should be reduced by a \$150,000 dividend to \$286,581.21. The \$436,581.21 item is reflected in taxpayer's books as a cash item. The item went into taxpayer's surplus account and was included in the financial statement of the company made to its stockholders. It was carried as a nontaxable item in accordance with taxpayer's understanding of what it was and because of Treasury Department regulations (R. 29).

In this examination and audit for the year 1929, the Commissioner did not, prior to his pleading in the Board of Tax Appeals on the taxpayer's petition to review a deficiency originally asserted on other grounds, include as taxable income or deductible loss any amount arising out of, or resulting from, the transactions hereinabove recited (R. 29).

The parties made a stipulation with respect to the deficiency originally asserted (R. 29-30). The Board of Tax Appeals ruled that taxpayer's gains from dealings in its own stock were taxable under the amended regulation, T. D. 4430, which it held valid (R. 21-40). The Circuit Court of Appeals held that the Treasury Regulations in effect during 1929 were consistent with Section 22 (a) of the Revenue Act of 1928, that they had received legis-

lative sanction through the continued reenactment of the statutory provision and were therefore controlling. It held that the gain from dealing in the taxpayer's own stock during the taxable year was not subject to tax, and reversed the decision of the Board of Tax Appeals (R. 108-116).

**SPECIFICATION OF ERRORS TO BE URGED**

The Circuit Court of Appeals erred:

1. In holding that the gain derived by the taxpayer from dealing in its own stock under the circumstances of this case was not subject to the Federal income tax.

2. In failing to hold that the gain derived by the taxpayer from dealing in its own stock under the circumstances of this case was taxable income under Section 22 (a) of the Revenue Act of 1928 and under the Sixteenth Amendment.

3. In holding that Article 66 of Treasury Regulations 74, prior to its amendment by T. D. 4430, was consistent with Section 22 (a) of the Revenue Act of 1928.

4. In failing to hold that Article 66 of Treasury Regulations 74, prior to its amendment by T. D. 4430, was in conflict with Section 22 (a) of the Revenue Act of 1928 and was therefore invalid.

5. In holding that T. D. 4430, amending Article 66 of Treasury Regulations 74, could not properly be applied retroactively.

6. In failing to hold that Article 66 of Treasury Regulations 74, as amended by T. D. 4430, was

valid, and applicable to the facts of this case.

7. In reversing the decision of the Board of Tax Appeals.

#### REASONS FOR GRANTING THE WRIT

1. The decision of the court below is in direct conflict with the decision of the Circuit Court of Appeals for the Third Circuit in *First Chrold Corp. v. Commissioner*, 97 F. (2d) 22. In both the instant case and the *First Chrold Corp.* case, the taxpayers were corporations dealing in their own stock and derived a gain from the sale of their own stock during the taxable years; in both cases the taxpayers bought their own stock for cash on the open market and sold it for cash, and there was no evidence to show that either corporation intended, or was authorized by its stockholders, to make a change in its capital set-up. In both cases the question is whether the gains are taxable under the general definition of "gross income" contained in Section 22 of the Revenue Acts of 1928 and 1932, *infra*, p. 26.<sup>1</sup> In both cases the Treasury Regulations interpreting this section provided in part, as originally promulgated, that a corporation realizes no gain or loss from the purchase or sale of its own stock; and prior to the hearing before the Board of Tax Appeals the Treasury Regulations were amended so as to provide that where a corporation deals in its own shares as it might in the shares of

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<sup>1</sup> The memorandum opinion of the Board of Tax Appeals discloses that the *First Chrold Corp.* case involved the taxable year 1932.

another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. T. D. 4430, *infra*, p. 27. In the instant case the Board of Tax Appeals held that the rule to be applied was that contained in the amended regulation and that, considering the magnitude and extent of the corporation's operations during the taxable year, its gains from dealings in its own stock constituted income under T. D. 4430 (R. 30, 34-40). In the *First Chrold Corp.* case, the Board held simply that its decision in the *R. J. Reynolds Tobacco Co.* case was controlling. See Prentice-Hall 1938 Federal Tax Service, vol. 1, par. 4.27.

In these cases, similarly treated in the Board, the Circuit Courts of Appeals reached conflicting results. In the instant case the court below refused to consider the correctness *vel non* of the rule set out in the amended regulation, or whether the Board had properly applied that regulation in the circumstances of this case,<sup>2</sup> but held that the amended regulation could not be applied at all because the regulation existing prior to the amendment was valid and had received legislative sanction. In the *First Chrold Corp.* case,<sup>3</sup> the Circuit

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<sup>2</sup> Because the court below did not rule on this question we are not giving it separate, extended consideration in this petition. If certiorari is granted, and respondent denies the applicability of the amended regulation, we shall argue the question more fully in the brief on the merits.

<sup>3</sup> The taxpayer filed a petition for rehearing in that case based on the decision of the court below in the instant case and the petition was denied on June 28, 1938; a supple-

Court of Appeals did consider the rule embodied in the amended regulation, approved that rule on the merits, and held that it had been properly applied to the circumstances of the case.

The diversity of opinion in the Circuit Courts of Appeals is intensified by the opinion of the Circuit Court of Appeals for the Second Circuit in *E. R. Squibb & Sons v. Helvering*, Prentice-Hall 1938 Federal Tax Service, par. 5.544, decided July 11, 1938. In that case the court also refused to apply the amended regulation and held that the regulation as originally promulgated had been confirmed through the acquiescence of Congress. The court stated: "We agree rather with *Reynolds v. Com'r*, 97 F. (2d) 302 (C. C. A. 4), than with *First Chrold Corp. v. Com'r*, 97 F. (2d) 22 (C. C. A. 3)." It may also be noted that the Court of Appeals for the Second Circuit injected another factor into the situation by holding that the corporation did realize gain to the extent that the sale price exceeded the value of the shares at the time of sale (as contrasted with the ordinary basis, e. g. cost price, used in the amended regulation), and remanded to the Board to assess a deficiency upon that basis.\*

2. The decision below is erroneous. It approves an interpretation of the Revenue Act exempting

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mental petition for rehearing was filed in July 1938, based on the decision of the Circuit Court of Appeals for the Second Circuit in *E. R. Squibb & Sons v. Helvering*, *infra*. The court has not yet acted on this petition.

\*The taxpayer has filed a petition for rehearing, which has not yet been acted upon.

taxpayers' gain from taxation. Section 22 (a) of the Revenue Act of 1928, *infra*, p. 26, provides in part that "gross income" includes gains, profits, and income derived from sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. None of the transactions in question are cases of the original issue of stock,<sup>5</sup> and there is no evidence in the record to show that the corporation intended, when it bought the stock, to reduce its capital, or, when it sold the stock, to increase its capital. The taxpayer simply went out on the open market and bought its own stock for cash, and afterwards sold the same stock for a greater amount of cash. From a practical point of view, the taxpayer has clearly derived a gain from the sale of personal property resulting from such transactions, within the meaning of Section 22 (a), and this Court has said that taxation is eminently practical. *Tyler v. United States*, 281 U. S. 497, 503.

That gain derived by a corporation from trading in its own stock under circumstances similar to those in the instant case constitutes income is con-

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<sup>5</sup> Article 66 of Treasury Regulations 74, as amended by T. D. 4430, expressly provides that the receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

vincingly explained by the Circuit Court of Appeals for the Third Circuit in *First Chrold Corp. v. Commissioner*, 97 F. (2d) 22. That court approved the distinction taken by the amended regulations between different types of dealing by a corporation in its own stock, and continued (pp. 22-23):

It is not easy to get in theory the concept of a corporation owning a share of itself and is perhaps not possible. Corporate shares are however easily thought of as property which may be bought and sold as are other kinds of property. A corporation may in a practical sense so deal in its own stock. When it does, the fact that it is its own stock, is ignored. We know this because corporations do so deal in their own stocks by buying and selling as they buy and sell other property, and this corporation did that very thing here. We are unable to accept the proposition that what it did in fact may be by the use of mental gymnastics turned into the theory that it was not buying and selling its stock as property but when it purchased was reducing the total sum of its capital stock and when it sold expanding its capital. A fairly good test of whether a gain is an income gain or a capital gain is whether it is distributable in dividends payable out of profits. This corporation bought shares of its stock at a price and sold it at a higher price. It in fact had taken in more than it had paid out and had the gain in hand. This was, considered of itself, properly distributable in dividends payable out of profits.

A cognate question considered by the Circuit Courts of Appeals has resulted in several rulings, with which the decision below seems to be inconsistent, that gain may be realized by a corporation exchanging property rights for its own stock, that such stock may constitute an asset in its hands, and that accounting theory looking to the contrary result may not be pressed "too far in disregard of plain facts." *Commissioner v. S. A. Woods Mach. Co.*, 57 F. (2d) 635 (C. C. A. 1st), certiorari denied, 287 U. S. 613; *Dorsey Co. v. Commissioner*, 76 F. (2d) 339 (C. C. A. 5th), certiorari denied, 296 U. S. 589; *Allyne-Zerk Co. v. Commissioner*, 83 F. (2d) 525 (C. C. A. 6th).

The court below did not consider on the merits the question whether a corporation may realize income from dealings in its own stock, but merely suggested that neither answer was without a reasonable basis, and applied the rule that reenactment of a statute after an interpretative ruling "amounts to a legislative sanction of the course pursued" (R. 115).

The court's fundamental error consisted in applying this doctrine without consideration of its exceptions,<sup>6</sup> and without recognition of the factor that a regulation seeking to determine what is

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<sup>6</sup>It is not controlling when the regulation is unclear. *Commercial Credit Co. v. Tait*, 2 F. (2d) 862 (D. Md.), aff'd on the opinion below, 7 F. (2d) 1022 (C. C. A. 4th). See discussion in *Dorsey Co. v. Commissioner*, 76 F. (2d) at 340, *supra*, of the purview of Art. 66 of Regulations 74, as originally promulgated.

income may involve very different considerations from a regulation promulgated under specific authority given in some section, or a regulation determining the proper classification or basis of an item of income or deduction, etc. It is settled that the reenactment doctrine does not apply where the statute itself is unambiguous (*Biddle v. Commissioner*, 302 U. S. 573, 582), or where the regulation allegedly confirmed creates a rule "out of harmony with the statute" and is therefore a nullity. *Manhattan Co. v. Commissioner*, 297 U. S. 129, 134-135. These qualifying rules operate with full force where the question turns, as this case does, on the coverage of the general definition of "gross income" reenacted in the several Revenue Acts. This Court has frequently pointed out that in this general definition Congress "intended to use its power to the full extent." *Irwin v. Gavit*, 268 U. S. 161, 166; *Helvering v. Stockholms &c. Bank*, 293 U. S. 84, 89; *Douglas v. Willcuts*, 296 U. S. 1, 9; *United States v. Safety Car Heating Co.*, 297 U. S. 88, 93; *Guaranty Trust Co. v. Commissioner*, 303 U. S. 493, 500. The statute and the intent of Congress are plain enough, and leave no discretion to the Treasury Department, though the determination as to what constitutes income may be a difficult one. The court's conclusion that both regulations constitute reasonable interpretations of the statute is apparently based on the difference of opinion among accounting authorities, many of which are cited in footnotes to the opinion of the

court below (R. 112, 113).<sup>7</sup> But this state of expert opinion does not enlarge the power of the Commissioner or permit him to exempt the income from tax if in truth gain derived from trading in a corporation's own stock may be income under the statute.

Congress did not intend, by its reenactment of Section 22, to commit itself to the theories of income promulgated by the Commissioner. In *Helvering v. Powers*, 293 U. S. 214, this Court said, concerning Treasury Regulations intended to interpret the constitutional doctrine of State immunity from Federal taxation (p. 224):

But the Treasury Department could not by its regulation either limit the provisions of the statute or define the boundaries of their constitutional application.

The statute may not be delimited by the Treasury Department's opinions concerning the nature of income any more than by its view as to the proper scope of the immunity doctrine. Thus this Court has recently characterized as inconsistent with the Revenue Acts, and therefore of no effect despite subsequent reenactment of the pertinent sections, regulations determining the basis of stock received by way of dividend which were "based upon the erroneous premise that stock dividends could not be income," *Helvering v. Gowran*, 302 U. S. 238, 244, note; *Koshland v. Helvering*, 298 U. S. 441,

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<sup>7</sup> See also *Journal of Accountancy*, 1938, June and July issues.

447. And this rule has its counterpart, perhaps buttressed by constitutional considerations, where the court feels that the regulation attempts to expand the income taxed by Congress. *Hewitt Realty Co. v. Commissioner*, 76 F. (2d) 880 (C. C. A. 2d), where the court said (p. 884):

\* \* \* this is not merely a question of the meaning of a statute, but of what can normally be taxed under the Sixteenth Amendment, and the re-enactment of the income tax law has little or no effect upon that.

Moreover, even under the view of the court below, that either of the Regulations can be deemed reasonable, its conclusion that the second cannot be applied retrospectively does not necessarily follow. Reenactment of a section under which a regulation has been promulgated "is persuasive evidence of legislative approval of the regulation," *Brewster v. Gage*, 280 U. S. 327, 337. But approval of the propriety of a regulation, as one promulgated consistently with the general authority of the Commissioner to prescribe all needful rules for the enforcement of the Revenue Act,<sup>8</sup> does not indicate an intention to tie the hands of the Commissioner in working out optimum administration of the statute, nor does it constitute an *ipso facto* rejection of any other regulation consistent with the statute determined by the Commissioner to effect a preferable implementation of the legislation.

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<sup>8</sup> Sec. 62 of the Revenue Act of 1928, c. 852, 45 Stat. 791, reenacted in the subsequent Revenue Acts. See also Rev. Stat., Sec. 161.

*Morrissey v. Commissioner*, 296 U. S. 344, 355; *Titsworth v. Commissioner*, 73 F. (2d) 385 (C. C. A. 3d). The permissibility of giving such amending regulation retrospective application to the date of enactment of the statute cannot be doubted (*Titsworth v. Commissioner, supra*), and, indeed, finds recognition—particularly where, as here, the amendment is occasioned by a court decision<sup>9</sup> (see *Morrissey v. Commissioner, supra*, 355), in the evolution of specific legislation authorizing the Commissioner to apply an amending regulation without retroactive effect.<sup>10</sup>

3. The Bureau of Internal Revenue advises that the same question is involved in six other cases, involving approximately \$220,000, now pending before the Board of Tax Appeals, and in at least eighteen cases, involving more than \$1,500,000, pending in the Bureau.

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<sup>9</sup> *Commissioner v. S. A. Woods Machine Co.*, 57 F. (2d) 635; see opinion below, R. 114.

<sup>10</sup> Sec. 1314 of the Revenue Act of 1921, c. 136, 42 Stat. 227, provided that in case of a reversal of a regulation not immediately occasioned or required by a decision of a court of competent jurisdiction, the subsequent regulation might be applied without retroactive effect. This provision was continued (Sec. 1008 (a) of the Revenue Act of 1924, c. 234, 43 Stat. 253; Sec. 1108 (a) of the Revenue Act of 1926, c. 27, 44 Stat. 9), until 1928 when the Congress authorized the application, without retrospective effect, of any regulation or Treasury decision amending another regulation or Treasury decision. Sec. 605 of the Revenue Act of 1928, c. 852, 45 Stat. 791, *infra*, p. 26.

**CONCLUSION**

Wherefore, it is respectfully submitted that this petition for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the Fourth Circuit should be granted.

ROBERT H. JACKSON,  
*Solicitor General.*

SEPTEMBER 1938.

## APPENDIX

### STATUTE AND OTHER AUTHORITIES INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

#### SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

This provision was reenacted in Section 22 (a) of the Revenue Act of 1932, c. 209, 47 Stat. 169.

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#### SEC. 605. RETROACTIVE REGULATIONS.

Section 1108 (a) of the Revenue Act of 1926 is amended to read as follows:

"SEC. 1108. (a) In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect." (U. S. C., Title 26, Sec. 1691.)

Treasury Regulations 74, relating to the Revenue Act of 1928:

**ART. 66. *Sale by corporation of its capital stock.***—The proceeds from the original sale by a corporation of its shares of capital stock, whether such proceeds are in excess of or less than the par value of the stock issued, constitute the capital of the company. If the stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount is not a loss deductible from gross income. If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the shareholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock. (See article 176.)

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The identical article is contained in Treasury Regulations 77, relating to the Revenue Act of 1932.

Treasury Decision 4430, approved May 2, 1934,  
XIII-1 Cumulative Bulletin 36:

ARTICLE 66: Sale by corporation  
of its capital stock. XIII-20-6792  
T. D. 4430  
(Also Section 23 (i), Article 176.)

#### INCOME TAX

Acquisition or disposition by a corporation of its own capital stock.

Articles 543 and 563, Regulations 65 and 69, and articles 66 and 176, Regulations 74 and 77, amended.

TREASURY DEPARTMENT,  
OFFICE OF COMMISSIONER  
OF INTERNAL REVENUE,  
Washington, D. C.

*To Collectors of Internal Revenue and  
Others Concerned:*

Articles 543 of Regulations 65, approved October 6, 1924, and Regulations 69, approved August 28, 1926, and articles 66 of Regulations 74, approved February 15, 1929, and Regulations 77, approved February 10, 1933, are hereby amended to read as follows:

*Acquisition or disposition by a corporation of its own capital stock.*—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from

such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of applicable statutes.

Articles 563 of Regulations 65, approved October 6, 1924, and Regulations 69, approved August 28, 1926, are hereby amended by striking out the first and second sentences thereof, by substituting the words "a corporation" in place of the second word in the third sentences of those articles, and by adding the following sentence to those articles:

As to the acquisition or disposition by a corporation of its own capital stock, see article 543.

Article 176 of Regulations 74, approved February 15, 1929, is hereby amended by omitting the first and second sentences thereof, by substituting the words "a corporation" in place of the second word in the third sentence of this article, and by adding the following sentence to this article:

"As to the acquisition or disposition by a corporation of its own capital stock, see article 66."

Article 176 of Regulations 77, approved February 10, 1933, is hereby amended by omitting the first and second sentences thereof, and by adding the following sentence to this article:

"As to the acquisition or disposition by a corporation of its own capital stock, see article 66."

GUY T. HELVERING,

*Commissioner of Internal Revenue.*

Approved May 2, 1934.

H. MORGENTHAU, Jr.,

*Secretary of the Treasury.*

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# **In the Supreme Court of the United States**

OCTOBER TERM, 1938

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No. 328

GUY T. HELVERING, COMMISSIONER OF INTERNAL  
REVENUE, PETITIONER

v.

R. J. REYNOLDS TOBACCO COMPANY

---

*ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT  
COURT OF APPEALS FOR THE FOURTH CIRCUIT*

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## **BRIEF FOR THE PETITIONER**

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### **OPINIONS BELOW**

The opinion of the Board of Tax Appeals (R. 14-28) is reported in 35 B. T. A. 949. The opinion of the Circuit Court of Appeals (R. 70-78) is reported in 97 F. (2d) 302.

### **JURISDICTION**

The judgment of the Circuit Court of Appeals was entered on June 6, 1938. (R. 78.) The petition for certiorari was filed on September 6, 1938, and granted on October 17, 1938. (R. 78.) The

jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

#### QUESTIONS PRESENTED

Respondent during 1929 sold through brokers on the New York Stock Exchange 209,000 shares of its own common stock, part of which it had purchased in 1921 and part in 1929. The aggregate amount of cash received by respondent on the sales exceeded the cost of the shares to it by \$286,531.21.

1. Does the gain thus derived by respondent from dealings in its own stock come within the definition of gross income in Section 22 (a) of the Revenue Act of 1928?

2. Must Article 66 of Treasury Regulations 74, as amended in 1934, which treats such gain as income, be denied application?

#### STATUTE AND OTHER AUTHORITIES INVOLVED

The statute and other authorities involved will be found in the Appendix, *infra*, pp. 51-54.

#### STATEMENT

The facts were found by the Board of Tax Appeals on the basis of a stipulation (R. 43-49), testimony of the chairman of the Board of Directors of the taxpayer (R. 50-61), and certain documentary exhibits (R. 62-67).

The taxpayer is a corporation organized in 1899 under the laws of New Jersey, having its principal office and place of business in Winston-Salem,

North Carolina, and engaged in the manufacture and sale of tobacco products (R. 15). The present controversy involves the year 1929. During that year respondent sold through brokers, on the New York Stock Exchange, a total of 209,000 shares of its own so-called new class B common stock (R. 18). One block of 15,000 shares had been acquired in 1921 at a cost to respondent of \$121,440.19 in cash. This block was sold for cash in the amount of \$708,690. Another block representing 94,500 shares had been purchased in the latter part of 1929 for cash in the amount of \$4,908,966.17. These were sold for cash in the amount of \$4,506,497. A third block of 99,500 shares had also been acquired in the latter part of 1929 for cash in the amount of \$4,601,807.43 (R. 18-19). These were sold for cash in the amount of \$4,703,608 (*Ibid.*). The stock certificates covering the shares thus sold in 1929 were endorsed, surrendered, cancelled and reissued in the same normal manner as sales and purchases of all of respondent's shares of stock. (R. 19.) The difference between the cost and the selling price of the shares thus sold, \$286,581.21, was reflected on respondent's books as a cash item; was placed in respondent's surplus account; and was included in the financial statement of the company made to its stockholders. (R. 19-20.) On respondent's income tax return for 1929 this amount was listed as "profit RJR stock" under the caption "Other Items of Non-taxable Income". (Ex. D, p. 3, following R. 48; cf. R. 17-18, 20-21.)

Other shares of its own stock which respondent had acquired in 1921 and in 1929 but which were not disposed of in 1929 were carried on the company's books as "Investments in Non-competitive Companies." (R. 19.) Of the amount of \$19,601,594.77 appearing on respondent's books in this account, \$19,270,690.98 represented such shares, 431,925 in number (*ibid.*). At no time did respondent's books show any increase or reduction in its capital stock on account of these transactions. (R. 19.)

By amended answer to respondent's petition in the Board of Tax Appeals (relating to other questions), the Commissioner asserted that respondent's net income should be increased by the amount of the "net profit realized by the R. J. Reynolds Tobacco Company through trafficking in Class B common stock of the R. J. Reynolds Tobacco Company." (R. 9.) Claim for deficiency was accordingly made (*ibid.*).

The Board included in its findings a detailed statement of the background and circumstances of the sales of stock in 1929 which are the subject of the present controversy. These may be stated as follows, giving first the events prior to 1929 and next the events in that year:

*Events prior to 1929.*—From time to time since 1901 the capital structure of the corporation has been changed by increases in the common stock by the issuance of new classes of common stock known

as class B common, later eliminated in favor of new class B common; by the issuance and subsequent retirement of preferred stock; by stock dividends; and by stock split-ups due to reduction in the par value of the common stock. (R. 15.) During the taxable year 1929 the total capitalization of R. J. Reynolds Tobacco Company was (R. 15):

1,000,000 shares common stock at \$10 par value.....	\$10,000,000
9,000,000 shares new class B common stock at \$10 par value.....	90,000,000
10,000,000 shares outstanding capital stock.....	\$100,000,000

The principal difference between common stock and new class B common is that the latter had no voting power and was not considered under the company's plan providing for participation by officers and employees in certain profits of the company. There was no authorization during the taxable year by charter amendment whereby the authorized number, class, or par value of taxpayer's shares of stock was increased or decreased. (R. 15.)

In 1912 the taxpayer was young in the tobacco industry, being a very small corporation whose stock was owned by one family until other stockholders were brought in from time to time. Its principal stockholder and founder was R. J. Reynolds, whose practice it was to bring as many employees as possible into the company as stockholders. Under the by-laws of the company the holders of the only stock then outstanding were entitled to a special distribution each year based on

the profits realized, and as a result the owners of this class of stock retained their holdings in order to participate in the profits. (R. 15.)

At 1912 taxpayer was in vigorous competition with three other tobacco companies, each having many times the capital of taxpayer. After 1912 taxpayer's growth was rapid. Its business prospered to such an extent that maintaining the capitalization of the company at a point where it could support the rapid expansion of the business, and meet competitive conditions, presented a serious problem. At the same time the management of the taxpayer desired to preserve (1) the reputation of the company, (2) the reputation of the stock, and (3) the behavior of the stock on the market, including its behavior in comparison with other similar stocks. (R. 15.)

In 1918 the taxpayer created the class B common stock which did not participate in the special distribution based on the company's profits, and which was, therefore, available on the open market. Later this class B stock was eliminated by charter amendment in April 1926. (R. 15-16.)

In July 1918 R. J. Reynolds, taxpayer's largest stockholder, died. It became necessary for his estate to sell a substantial portion of the stock in order to pay the inheritance taxes on his estate. This stock was purchased by several individuals, but subsequently and prior to 1921 it was finally concentrated in the single ownership of United Retail Stores, which controlled United Cigar Stores

a large distributor of taxpayer's tobacco products. United Retail Stores publicized the fact that it owned a substantial block of taxpayer's stock. Rumors developed and the suspicion grew that United Retail Stores was dictating taxpayer's business policies and was able to buy taxpayer's tobacco products at lower prices and for better discount than other distributors and retailers. Furthermore, the dividends regularly paid by the taxpayer made it possible for United Retail Stores to operate its approximately 2,000 retail stores without profit, and yet have a substantial amount with which to pay dividends to its own stockholders. (R. 16.)

It was the judgment of taxpayer's management that the reputation of the company and the necessity of protecting its business required the purchase of this United Retail Stores stock. Taxpayer had recognized in 1918 the necessity of broadening its stockholding base, and the acquisition of this block of stock afforded taxpayer an opportunity to remove a harmful situation and at the same time permitted taxpayer to expand its stockholding list by feeding the stock back onto the market. The law department of the taxpayer considered and ruled that taxpayer was authorized to make the 1921 purchase, and the other purchases hereinafter related, and reissue the stock, although taxpayer had no charter authority to deal in its own stocks. (R. 16.)

For the reasons aforementioned the taxpayer purchased during 1921 the block of old class B common stock held by United Retail Stores, the number of shares purchased being undisclosed. The purchase was made at a private sale, the stock in question not being listed on any exchange in 1921. The consideration paid was \$607,200.96 in cash, which was slightly under the market price by reason of the amount of stock involved. As a result of subsequently effected stock split-ups and stock dividends that portion of this purchase here involved came to represent 75,000 shares of new class B common stock, the certificates therefor being held by taxpayer on January 31, 1929. (R. 16.)

During all the years 1921 to 1929, inclusive, and thereafter, the taxpayer followed the same general policy of availing itself of all opportunities that were presented for extending its stockholding base. The effectiveness of this general policy is revealed by the increase in the number of taxpayer's stockholders over a period of years. In March, 1922, when taxpayer's stock was listed on the New York Stock Exchange, taxpayer had less than 2,000 stockholders, counting common stock and class B common stock. At the time of the market crash in 1929 there were 9,136 shareholders of B stock alone. In 1933 there were 41,000 stockholders and in April, 1936, there were 52,000 holders of B stock. (R. 16-17.)

In 1924 taxpayer sold for cash 21,067 shares of the stock purchased in 1921 from United Retail Stores. The sales were made in the second and third quarters of 1924 on a rising market, following a substantial drop of the market in the first quarter. (R. 17.)

In 1925 the taxpayer sold for cash 11,000 shares of the stock purchased in 1921 from United Retail Stores. These shares were sold or reissued between February 10 and August 13, 1925. The management took advantage of a rising market to dispose of these shares without hurting its stock or the reputation of the taxpayer. (R. 17.)

By reason of a charter amendment in 1926 the management of taxpayer feared that speculators on the market might start a rumor that taxpayer would declare a stock dividend. To protect the reputation of the stock, which included keeping it from jumping and precipitately dropping, the taxpayer purchased through a broker for cash 21,400 shares of its stock. After fear of the rumor had passed the 21,400 shares were gradually fed back into the market. (R. 17.)

In 1927 the taxpayer's only transaction respecting its own stocks was the disposition of certain fractional shares accumulated in its hands in connection with the issuance of rights to subscribe or receive additional stock. These fractional shares, which had cost taxpayer nothing, were disposed of for cash in the amount of \$240.83. (R. 17.)

During April 1928, taxpayer reduced the price of its cigarettes from \$6.40 to \$6 per thousand. Following this reduction the volume of taxpayer's stock offered on the market was greatly multiplied. Taxpayer, with a view to protecting the reputation of the stock of the company, its business, and its brands, purchased for cash 43,300 shares of its stock, expecting thereby to protect the market against a precipitate fall in prices. After the market steadied the 43,300 shares were fed back into the market, together with 1,240 shares of the stock acquired from United Retail Stores in 1921. (R. 17.)

During each of the aforesaid years 1924 to 1928, inclusive, the taxpayer, R. J. Reynolds Tobacco Company, reissued solely for cash certain shares of its new class B common stock, theretofore acquired solely for cash, in a manner similar to that hereinafter set forth with respect to the taxable year 1929. Such transactions were made under circumstances and for reasons substantially similar to those surrounding the said similar transactions in the year 1929. For the purpose only of showing generally the result of such transactions during each of said years 1924 to 1928, inclusive, and for no other purpose, the parties below agreed that, in executing its income tax return for each of such prior years, the taxpayer noted in "Schedule L—Reconciliation of Net Income and Analysis of Change in Surplus" and under subtitle (of

said Schedule L) entitled "2. Non-taxable income  
 \* \* \* (f) Other Items of Non-Taxable Income  
 (to be detailed)" under the notation "Profit R. J.  
 R. Stock," or substantially similar notation, the  
 following amounts (R. 17-18):

Years:	Amounts:
1924-----	\$999,335.25
1925-----	601,507.42
1926-----	85,003.70
1927-----	240.83
1928-----	1,271,023.19

At the close of 1928 taxpayer had 30,000 shares of its new class B common stock, which became 75,000 shares by January 31, 1929, due to a  $2\frac{1}{2}$  for 1 split-up approved by the stockholders on December 28, 1928, thus reducing the par value of the stock from \$25 per share to \$10 per share. (R. 18.)

*Events during 1929.*—Subsequent to January 31, 1929, the taxpayer canceled certificates representing 15,000 shares of said 75,000 shares acquired in 1921 and issued in lieu thereof new certificates representing 15,000 shares of new class B common stock to divers persons who delivered to taxpayer the sum of \$708,690 in cash for said 15,000 shares. The 15,000 shares so disposed of by taxpayer were acquired as a part of taxpayer's 1921 purchase at a cost to taxpayer of \$121,440.19 in cash. (R. 18.)

On December 18, 1929, 2,106,139 shares, or more than 23 percent of the total outstanding 9,000,000 shares of taxpayer's new class B common stock, were in the hands of brokers, subject to trading or speculation. This stock was in a position to do

great injury to taxpayer, its stock, and its products. Approximately 2,000 employees of taxpayer held shares of its stock and many of them had borrowed heavily on their stock. With the then market price of approximately 64, a heavy drop in the market would have been disastrous to many of taxpayer's employees. (R. 18.)

At the time of the market break in 1929 taxpayer had \$29,000,000 in cash and Government securities, which the management determined to and did use in purchasing the taxpayer's stock offered on the market during the break in October and November 1929. During the height of the stock market panic, from approximately October 29 to November 13, 1929, taxpayer held the market price of its stock at 50, purchasing 90 per cent of its stock offered on the market. As the panic eased, taxpayer's purchases were scaled down to 40 and 39. During the taxable year 1929 taxpayer purchased a total of 574,880 shares of its own stock. (R. 18.)

In addition to selling the 15,000 shares aforementioned during 1929, taxpayer sold 194,000 other shares of the new class B common stock it had purchased in 1929. One block representing 94,500 shares of new class B common stock was acquired by taxpayer for cash in the amount of \$4,908,966.17. Later in 1929 taxpayer canceled the certificates representing these 94,500 shares, issuing new class B common stock certificates in lieu thereof to divers persons for \$4,506,497 in cash. Another block of 99,500 shares of new class B common stock

was acquired by taxpayer in 1929 for \$4,601,807.43 in cash. Later in 1929 taxpayer canceled the certificates representing these 99,500 shares, issuing new class B common stock certificates in lieu thereof to divers persons for \$4,703,608 in cash. The transactions covering the said 94,500 and 99,500 share blocks of stock were handled by brokers on the New York Stock Exchange. (R. 18-19.)

At all times during 1929 the stock books and records of the taxpayer indicated that the number of its new class B common stock issued and outstanding was 9,000,000 shares. From the time of acquisition of the certificates representing shares of taxpayer's stock until the time of their cancellation and the issuance of new certificates in lieu thereof, the said certificates were regularly entered and recorded on the balance sheets in the financial statement of taxpayer under the entry "Investments in Non-competitive Companies," in which all of such stock was entered and carried at the amount of cash for which it was acquired. The said transactions in respect thereof were not entered or recorded in any records of taxpayer as either increasing or reducing the number of the outstanding shares of its capital stock. At the times of the acquisitions by taxpayer of certificates representing its capital stock, as set forth hereinabove, the cash of taxpayer was reduced by the amounts of cash expended for their acquisition. Likewise, at the

times in 1929 when the said certificates were disposed of, the cash of taxpayer was increased by the amounts received from the disposition thereof. (R. 19.)

At the close of the taxable year the taxpayer had on hand 431,925 shares of its new class B common stock. As of December 31, 1929, these shares represented \$19,270,690.98 out of the \$19,601,594.77 total appearing on taxpayer's books in the amount designated "Investments in Non-competitive Companies." The balance of the account represented investments in the stock of two small licorice companies (from which taxpayer secured its supplies of licorice), and stock in the Glenn Tobacco Company. None of the shares of stock of the last mentioned three companies was for sale or was traded in by taxpayer. (R. 19.)

The profit from the sale by taxpayer of its own shares of stock arose solely through the sale of new class B common stock. The stock certificates covering the shares sold in 1929 were endorsed, surrendered, canceled, and reissued in the same normal manner as sales and purchases of all of taxpayer's shares of stock. Each transaction involved herein was a completed and closed transaction in the taxable year 1929. During 1929 each and every acquisition and each and every sale made by taxpayer of its own stock was for cash and in no instance for anything except cash. (R. 19.)

Taxpayer's 1929 income tax return, Schedule L, indicates a nontaxable profit of \$436,581.21. It was stipulated that the last mentioned figure should

be reduced by a \$150,000 dividend to \$286,581.21. The \$436,581.21 item is reflected in taxpayer's books as a cash item. The item went into taxpayer's surplus account and was included in the financial statement of the company made to its stockholders. It was carried as a nontaxable item in accordance with taxpayer's understanding of what it was and because of Treasury Department regulations. (R. 19-20.)

In his examination and audit for the year 1929, the Commissioner did not, prior to his pleading in the Board of Tax Appeals on the taxpayer's petition to review a deficiency originally asserted on other grounds, include as taxable income or deductible loss any amount arising out of, or resulting from, the transactions hereinabove recited. (R. 20.)

The parties made a stipulation with respect to the deficiency originally asserted. (R. 20.)

The Board of Tax Appeals ruled that taxpayer's gains from dealings in its own stock were taxable under the amended regulation, T. D. 4430, which it held valid. (R. 20.) The Circuit Court of Appeals held that the Treasury Regulations in effect during 1929 were consistent with Section 22 (a) of the Revenue Act of 1928, that they had received legislative sanction through the continued reenactment of the statutory provision and were therefore controlling. It held that the gain from dealing in the taxpayer's own stock during the taxable year was not subject to tax, and reversed the decision of the Board of Tax Appeals. (R. 70-78.)

**SPECIFICATION OF ERRORS TO BE URGED**

The Circuit Court of Appeals erred:

1. In holding that the gain derived by the taxpayer from dealing in its own stock under the circumstances of this case was not subject to the Federal income tax.

2. In failing to hold that the gain derived by the taxpayer from dealing in its own stock under the circumstances of this case was taxable income under Section 22 (a) of the Revenue Act of 1928 and under the Sixteenth Amendment.

3. In holding that Article 66 of Treasury Regulations 74, prior to its amendment by T. D. 4430, was consistent with Section 22 (a) of the Revenue Act of 1928.

4. In failing to hold that Article 66 of Treasury Regulations 74, prior to its amendment by T. D. 4430, was in conflict with Section 22 (a) of the Revenue Act of 1928 and was therefore invalid.

5. In holding that T. D. 4430, amending Article 66 of Treasury Regulations 74, could not properly be applied retroactively.

6. In failing to hold that Article 66 of Treasury Regulations 74, as amended by T. D. 4430, was valid, and applicable to the facts of this case.

7. In reversing the decision of the Board of Tax Appeals.

**SUMMARY OF ARGUMENT****I**

The gain derived by respondent from its dealings in its own stock is gross income under Section 22

(a) of the Revenue Act of 1928. The broad range of the statutory definition of gross income has been repeatedly emphasized by this Court. The definition is intended to embrace whatever is commonly understood as income, and it is essentially coextensive with the scope of Congressional power under the Constitution. Here the corporation realized a gain in cash, in the amount of the excess of receipts from the sale of its stock over their cost to the corporation, without any attendant change in the number or nature of its shareholding accounts. This is a typical case of realized corporate gain as commonly understood.

It avails nothing to label a realized gain in cash an accretion to capital. This is shown by the cases holding that taxable income is derived from the conversion of capital assets, and from bond premiums. *Merchants Loan & Trust Co. v. Smietanka*, 255 U. S. 509; *Old Colony R. Co. v. Commissioner*, 284 U. S. 552. The distinction between what was done here and the actual retirement and reduction of capital stock with the issuance of new capital, is a difference having important legal and practical features.

A number of courts have held that a corporation's own stock taken in exchange for property or in settlement of a debt to the corporation is itself property under the Revenue Acts.

The treatment by accountants of treasury stock and gains on its sale is a subject of wide difference of opinion. In any event, such accounting practice or theory would not be determinative. Re-

spondent treated the treasury stock as assets and the gain on its sale as income, though nontaxable. Suggestions that such gain should be credited to a capital surplus account are founded chiefly on considerations of business judgment, particularly in view of the dangers inherent in the power of a corporation to deal in its own shares.

## II

Article 66 of Regulations 74, under the Revenue Act of 1928, as the article was amended in 1934, clearly treats the gain in the present case as income. Congress has given express authority in the Revenue Acts to make amended regulations thus effective. Whether amended regulations shall have prospective effect only is a matter confided by the statute to the discretion of the Commissioner and the Secretary.

The fact that the definition of gross income was reenacted without change while earlier and different regulations were in effect should not prevent the application of the amended regulation. The amended regulation has itself been followed by two Congressional reenactments. If the doctrine of reenactment is to be applied, it is thus necessary to choose between implied approval of the earlier regulations and implied approval of the amended regulations. In such a situation the express authority conferred on the Commissioner to amend the regulations should be controlling.

The cases in which this Court has applied the rule of reenactment were not concerned with subsequent amendment. Where that question has been presented, the amended regulations have been given effect. *Morrissey v. Commissioner*, 296 U. S. 344; *Murphy Oil Co. v. Burnet*, 287 U. S. 299.

The rule of reenactment can have little bearing here, where the regulations purport to interpret general statutory language which is in substance coextensive with constitutional power. Cf. *Helvering v. Powers*, 293 U. S. 214, 224. There is no good reason why the Commissioner, in performing the function of interpretation, may not reexamine and reformulate his interpretations much as do the courts. Cf. *Manhattan Co. v. Commissioner*, 297 U. S. 129, 135. The exercise of this power in the present situation was particularly appropriate, in view of decisions of the courts indicating that the then existing regulations were untenable or unclear. And the Commissioner's position looks to the recognition of losses as well as gains.

In amending the regulations the Commissioner has properly left to Congress the question whether disproportionate hardship will result to certain classes of taxpayers entitling them to remedial legislation; and has necessarily left to the courts the question whether the amended regulations are a sound interpretation of the statutory and constitutional concept of income.

## ARGUMENT

## I

THE GAIN DERIVED BY RESPONDENT FROM DEALINGS IN  
ITS OWN STOCK IS GROSS INCOME UNDER SECTION 22 (a)  
OF THE REVENUE ACT OF 1928

By virtue of sales of its stock on the market in 1929 at an aggregate price exceeding the price which it had paid for the shares, the respondent realized a cash increment in that year in the amount of \$286,581.21. The question in this case is whether that cash increment may be included in respondent's gross income. This question may conveniently be discussed under two aspects: (1) whether the amount is gross income within the scope of the Revenue Act of 1928; and (2) whether the regulations in their present form, which are applicable in terms and which require the inclusion of this amount in gross income, must be denied application because of the existence of earlier and different regulations.

In considering the first of these two points, it is important that the scope of the statutory definition of gross income be kept clearly in view. Section 22 (a) of the Revenue Act of 1928, which is the same in substance as the corresponding section in prior and subsequent Acts, defines gross income as follows:

*General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in

whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

The broad sweep of this provision has been recognized repeatedly by this Court. In its definition of income "Congress intended to use its power to the full extent." *Irwin v. Garit*, 268 U. S. 161, 166; *Douglas v. Willcuts*, 296 U. S. 1, 9. Or, as it has also been said, Congress has revealed an intention "to reach pretty much every sort of income subject to the federal power." *United States v. Safety Car Heating Co.*, 297 U. S. 88, 93; *Helvering v. Stockholms Enskilda Bank*, 293 U. S. 84, 89.

In applying the definition of income it must be kept in view also that the term was used not in any special or technical sense; it is to be given "the commonly understood meaning of the term which must have been in the minds of the people when they adopted the Sixteenth Amendment to the Constitution." *Merchants Loan & Trust Co. v. Smietanka*, 255 U. S. 509, 519. Thus in dealing with the term "gross income" there is especial reason for applying the rule that the words of a Revenue Act are presumed to be used in their ordinary and usual sense, and with the meaning commonly

attributable to them. Cf. *De Ganay v. Lederer*, 250 U. S. 376, 381.

In the light of the principles that Congress has intended to reach gross income to the full extent of its constitutional power, and that the concept is to be given its ordinarily understood meaning, we may examine the salient facts of the transactions in question. The stock which the respondent purchased and wished to sell was held in the name of a nominee. The respondent granted an option on some of the stock to certain parties at a stated price for the purchase of shares, and the optionees proceeded to make such disposition of the shares as they could and called for delivery. Upon confirmation, the stock was endorsed in blank by the taxpayer's nominee and delivered to the optionee. The stock books of respondent did not show any different treatment of these certificates than of any other certificates. Those shares which the respondent had purchased for resale but which in fact were not sold during the taxable year were carried on its books as "investments in non-competitive companies". Of the amount of \$19,601,594.77 shown in that account, \$19,270,690.98 represented respondent's own stock of the class here involved. Not only did respondent carry this stock on its books as an investment, but it paid dividends to itself on this stock as dividends were declared. The books and records of respondent indicated no change in the number of its outstanding shares,

either as a result of the acquisition of its shares or of their resale. At the time of the acquisition of the shares the respondent's cash was reduced by the amount expended; and when the shares were disposed of by respondent, its cash was increased by the amounts received. It is the increment in the cash account of respondent which is here sought to be taxed.

It seems to us plain that what was said in *Irwin v. Gavit*, 268 U. S. 161, 166, is equally pertinent here: "If these payments properly may be called income by the common understanding of that word and the statute has failed to hit them it has missed so much of the general purpose that it expresses at the start." It will be observed that there is no question in the present case of the *realization* or *receipt* of income; the amount involved was cash paid into the hands of respondent in the taxable year. If the amount by which the taxpayer's cash account was enriched is not to be regarded as income, the scope of that concept will fail to accord with ordinary understanding.

No court has undertaken to hold that the enrichment thus realized by a corporation's dealing in its own shares is not within the constitutional ambit of the income tax. The court below was careful to declare only that in its opinion differing views of the statute were permissible. The Circuit Court of Appeals for the Third Circuit in *First Chrold Corporation v. Commission*, 97 F. (2d) 22, pend-

ing on certiorari, No. 385, held the gain taxable. The Circuit Court of Appeals for the Second Circuit in *E. R. Squibb & Sons v. Helvering*, 98 F. (2d) 69, expressly refrained from intimating that such gain could not be taxed by Congress as income under the Sixteenth Amendment (p. 70). This view of the decisions is apparently shared by respondent (Brief in Opposition, 15-18). In view of the recognition by this Court, as noted above, of the coextensive scope of the Sixteenth Amendment and the statutory definition of gross income, it would be difficult to rule out this gain from the definition of gross income on any other than constitutional grounds; and no such grounds have been taken.

The principal consideration urged against treating the gain as income is that it is in the nature of the proceeds derived from the original issuance of shares. It is agreed that in the latter situation the amount received by the corporation is not income. But the analogy is a fallacious one. The original issuance of shares results in the creation of corporate capital. The cash or property received by the corporation is offset by the creation of a corresponding liability to shareholders. But where a corporation acquires its own shares and sells them on the market without a retirement or reduction of its capital stock, the situation is fundamentally different. In such a situation, viewing the position of the corporation immediately before the purchase and immediately after the sale, the cash assets

of the corporation have been augmented (or diminished) without any change in the claims of shareholders against the corporation. The amount by which the assets have been thus augmented is clearly gain, and gain to the corporation itself.

It is submitted that the analysis in the *Squibb* case, *supra*, is faulty for the reason that the court there compared the position of the corporation before and after the sale of its treasury shares, instead of comparing its position before the acquisition of the shares and after their sale. It is the dealing in the shares—their acquisition and sale, without retirement—which gives rise to income.

An additional word should be said about the supposed analogy to the retirement of shares and the issuance of new shares. The difference between what was done in the present case and what would have been done in the case of retirement is more than a difference in form. Important legal and practical distinctions are involved. The purchase by a corporation of its shares without retirement enables it to sell them without observing the preemptive right of shareholders; to sell them without conformity to the legal requirements as to the price which must be received; to sell them without conformity to statutory or charter requirements that a reduction in capital stock be effected by a vote of the board of directors and of stockholders and the filing of public notice thereof. A corporation which is enabled to secure these advantages by refraining

from retiring the stock cannot urge, it is submitted, that what it did was tantamount to retirement and reduction of capital.

Furthermore, the distinction between the holding of treasury shares and the retirement of stock is carefully observed in the taxing law of respondent's state of incorporation. New Jersey imposes a franchise tax measured by capital stock "issued and outstanding." It is there held that the tax is properly imposed on treasury shares. *Knickerbocker Importation Co. v. Board of Assessors*, 74 N. J. L. 583. In that case the New Jersey court distinguished sharply between a true reduction in capital stock, which must be effected in accordance with the statutory procedure, and an acquisition of stock held by the corporation as treasury shares. "Stock once issued", the court said (p. 590), "is and remains outstanding until retired and canceled by the method provided by statute for the retirement and cancellation of capital stock; \* \* \*." (Per Dill, J.)

It is argued that corporate stock held as treasury shares cannot be regarded as assets or property of the corporation, and that hence gain derived from its disposition is not income derived from "dealings in property" within the statutory definition of gross income. This argument ignores the fact that the definition of gross income is not thus limited. It extends to "gains or profits and income derived from any source whatever." Furthermore, it cannot be said that treasury shares are not prop-

erty from the standpoint of the corporation. If a corporation acquires or deals in its own shares as it might in the shares of another corporation, its own shares constitute property within the meaning of the Revenue Act. This principle has been established in a number of cases which merit discussion here because of their effect in leading to a re-examination and reformulation of the regulations concerning dealings by a corporation in its own shares. These decisions involved the question of gain or loss on the sale or exchange of property for cash or other property.

The first of these decisions is *Walville Lumber Co. v. Commissioner*, 35 F. (2d) 445 (C. C. A. 9th, 1929), in which the taxpayer claimed a loss upon the dissolution of a corporation in which it owned a majority of the stock, and which in turn owned a majority of the taxpayer's stock. The Government contended that the transaction amounted to a purchase by the taxpayer corporation of its own stock which could not result in gain or loss under the Treasury Regulations. This argument apparently was based on Article 542 of Treasury Regulations 45, relating to the Revenue Act of 1918, which provided that a corporation realizes no gain or loss from the purchase of its own stock and which corresponds to Article 66 of Treasury Regulations 74, *infra*, p. 51, prior to its amendment by Treasury Decision 4430, *infra*, p. 52. The court rejected the Government's contention that this was a capital

transaction, and treated the taxpayer's own stock like any other property. The decision of the Board of Tax Appeals was reversed.

The *Walville Lumber Co.* case was followed by a decision of the First Circuit in *Commissioner v. S. A. Woods Mach. Co.*, 57 F. (2d) 635 (1932), certiorari denied, 287 U. S. 613, in which it was held that the receipt of its own stock by the taxpayer corporation constituted income, the Treasury Regulations to the contrary notwithstanding. In that case the taxpayer sued another corporation for infringement of a patent; and the parties entered into a settlement under which the other corporation transferred to the taxpayer about 1,000 shares of taxpayer's stock having a value of about \$433,000. The question involved was whether the value of the stock received by the taxpayer was taxable income. The case arose under the Revenue Act of 1924 and the applicable Treasury Regulations, which provided in part that "a corporation realizes no gain or loss from the purchase or sale of its own stock." In that case the court said (p. 636):

Whether the acquisition or sale by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction involved. *Walville Lumber Co. v. Com. of Internal Revenue* (C. C. A.) 35 F. (2d) 445; *Spear & Co. v. Heiner* (D. C.) 54 F. (2d) 134. If it was in fact a capital transaction, i. e., if the shares were acquired or parted with in connection with a read-

justment of the capital structure of the corporation, the Board rule applies. *Doyle v. Mitchell Bros. Co.*, 247 U. S. 179, 184; *Eisner v. Macomber*, 252 U. S. 189. But where the transaction is not of that character, and a corporation has legally dealt in its own stock as it might in the shares of another corporation, and in so doing has made a gain or suffered a loss, we perceive no sufficient reason why the gain or loss should not be taken into account in computing the taxable income. \* \* \*

The transaction involved in this case was equivalent to the payment of the debt in cash and the investment of the proceeds by the corporation in its own stock. If that had been done clearly the cash received would have been taxable income. The transaction was not changed in its essential character by the fact that, as the debtor happened also to own the stock, the money payment and the purchase of stock were bypassed, and the stock was directly transferred in payment of the debt. The stock was the medium in which the debt was paid.

Again the decision of the Board was reversed.

The *Woods Mach. Co.* case in turn was followed by a decision of the Third Circuit in *Commissioner v. Boca Ceiga Development Co.*, 66 F. (2d) 1004 (1933), in which the taxpayer sold a tract of land to one of its stockholders for a gross consideration of \$504,000 and received from the purchaser 480 shares of its capital stock, valued at \$48,000, as the initial payment. The question involved was

whether the taxpayer realized any taxable gain on the initial payment made to it with its own stock. The Board of Tax Appeals had held that a corporation realizes neither gain nor loss from the purchase of its own stock, and decided the case in favor of the taxpayer. The Circuit Court of Appeals decided in effect that a corporation's own stock was property under the circumstances of that case, and reversed the decision of the Board of Tax Appeals upon the authority of the *Walville Lumber Co.* case.

A similar result was reached by the Circuit Court of Appeals for the Fifth Circuit in *Dorsey Co. v. Commissioner*, 76 F. (2d) 339 (C. C. A. 5th, 1935), certiorari denied, 296 U. S. 589. In that case the taxpayer, a corporation, sold property and took as the purchase price cash and 1,000 shares of its own stock. The transaction occurred in 1928, prior to the time that Article 66 of Treasury Regulations 77 was amended, but the case was not decided by the Board of Tax Appeals or the Circuit Court of Appeals until after the Treasury Regulation was amended by T. D. 4430 in 1934. Both the Board of Tax Appeals and the Circuit Court of Appeals decided that under the circumstances the value of the stock should be considered as part of the purchase price which the taxpayer received on account of the sale of its property. The court said (p. 340):

That gain or loss arising in such an exchange of property of the corporation for

its own stock is realizable, the later and better considered decisions have held, even before the change of the Regulation. *Walville Lumber Co. v. Commissioner* (C. C. A.) 35 F. (2d) 445; *Spear & Co. v. Heiner* (D. C.) 54 (2d) 134, 135; *Commissioner v. Boca Ceiga Development Co.* (C. C. A.) 66 F. (2d) 1004. \* \* \*

And the Circuit Court of Appeals for the Sixth Circuit reached a similar conclusion in *Allyne-Zerk Co. v. Commissioner*, 83 F. (2d) 525 (C. C. A. 6th) (1936), where the stock received by the corporation was cancelled. In answer to the argument that the stock acquired by the corporation did not constitute an asset in its hands, and that the benefit accrued to the stockholders, not to the corporation, the court said (p. 526):

It is true that the value of the remaining shares was substantially enhanced by the cancellation of the certificates surrendered, and in this sense the remaining shareholders were benefited. However, the petitioner received the stock as a part of the consideration for the sale of the assets. Hence the transaction falls within the exact terms of section 202 (c) of the Revenue Act of 1924, c. 234, 43 Stat. 253, 255, "The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received." \* \* \*

It avails nothing to label the gain in question an accretion to capital. We have already pointed out

the distinction between this gain and the proceeds on the creation of capital stock. The concept of income received is not to be restricted simply by pointing to an increase of capital. An attempt of this sort was made early in the history of the income tax Acts, and was rejected by this Court. It was strenuously urged that the conversion of capital assets could not give rise to income, but only to a substitution or "increase of capital", not taxable under the Sixteenth Amendment. This view appeared at first to prevail (*Lynch v. Turrish*, 247 U. S. 221, 230), but was later repudiated (*Merchants Loan & Trust Co. v. Smietanka*, 255 U. S. 509), the Court emphasizing the broad range of both the statutory and the constitutional concepts of income. In a real sense the conversion of capital assets does produce an accretion to capital. But, as was decided, that fact is not inconsistent with recognition of the realized enrichment as income. Again, in *Old Colony R. Co. v. Commissioner*, 284 U. S. 552, it was argued that bond premium is not income because it is part of the capital loaned to the debtor. Doubtless, this Court said, the premium is "acquired capital" (p. 559). "But if this be admitted", the Court continued, "the concession does not answer the question whether a premium paid prior to 1913 is taxable." (*Ibid.*)

What has just been said indicates that accounting practice or theory is not a safe guide to measure the extent of the concept of income in the revenue Acts. The court below laid great stress on the con-

troverſy among accountants as to the ideal method of treating gains from dealings in a corporation's own ſhares. Even if accounting practice in this regard were more ſettled than it is, and failed to treat ſuch gains as income, the ſtatutory definition of income would not have to be reſtricted accordingly. As this Court has pointed out, "Taxability has frequently been determined without reference to factors which the accountant, economist or buſineſs man might deem relevant to the computation of net gain." *Helvering v. Midland Ins. Co.*, 300 U. S. 216, 225, note 9, citing *Brushaber v. Union Pacific R. Co.*, 240 U. S. 1; *Tyee Realty Co. v. Anderson*, 240 U. S. 115; *Weiss v. Wiener*, 279 U. S. 333; *Helvering v. Independent Life Ins. Co.*, 292 U. S. 371. Even rules of accounting which are enforced upon the taxpayer by another agency of the Government do not control the determination of tax liability. This Court ſaid, in *Old Colony R. Co. v. Commissioner*, 284 U. S. 552, 562: "Moreover, the rules of accounting enforced upon a carrier by the Interstate Commerce Commission are not binding upon the Commissioner, nor may he reſort to the rules of that body, made for other purpoſes, for the determination of tax liability under the revenue acts."

In the preſent caſe there are ſpecial additional reaſons why accounting practice and theory cannot ſerve to take reſpondent's gain out of the category of income. The firſt reaſon is that reſpondent's own accounting practice, like that of many other

corporations,<sup>1</sup> treated the treasury shares as assets ("investments in non-competitive companies") and the gain on sale as income. Respondent's tax returns, in reconciling its book income with its taxable income, denominated the gain "non-taxable income." (R. 17-18.) The second and more fundamental reason is that insofar as accounting authority recommends a different treatment,—as for example a reduction in the outstanding shares shown, on acquisition of the stock, and an addition to capital surplus on sale at a profit—the recommendation is founded on practical considerations intended to lessen the possibility of dangers and abuses in a corporation's dealings in its own shares. Because of the emphasis placed by the court below on the conflicting views of accountants, it seems desirable to explain more fully the level of discussion upon which those views proceed.

The accountant's function, of course, is to disclose the financial condition of the corporation in a manner most instructive to the management and to creditors and investors. In taking account of treasury shares, conservative accounting practice might well be guided by the possibilities of injury and deception involved. From the standpoint of creditors and investors, as well as of sound man-

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<sup>1</sup> In Holt and Morris, *Some Aspects of Reacquired Treasury Stock, 1931-1933*, 12 Harvard Business Review 505, 508, it is stated that out of 80 corporations investigated 25 carried treasury stock as an asset.

agement,' the acquisition of shares by a corporation may perhaps be viewed as a contraction of its assets; and gain derived from the sale of the shares may be viewed as a profit extraneous to the earning capacity of the business. Treasury shares have on occasion been used for the purpose of circumventing the provisions of law requiring newly-issued stock to be fully paid, for the purpose of vesting voting control in a minority of stockholders, for the purpose of granting preferential treatment to selected stockholders, and for other objectionable purposes.<sup>3</sup> Because of the possibilities of injury and deception, the purchase by a corporation of its own shares without their retirement is in general forbidden by English and Continental law.<sup>4</sup> Here,

<sup>3</sup> The importance of the accounting treatment of treasury stock from the standpoint of the dividend policy of the corporation is emphasized in R. E. Payne, *Treasury or Re-acquired Stock*, Certified Public Accountant, Feb. 1936, p. 98.

<sup>4</sup> See 1 Machen, *Modern Law of Corporations*, sec. 626; 1 Morawetz, *Private Corporations* (2d ed.) sec. 112; Levy, *Purchase By a Corporation of Its Own Stock*, 15 Minnesota Law Review 1. The Committee on Stock List of the New York Stock Exchange declared, in December 1933: "The Committee on Stock List has long urged corporations not to trade in their own shares. The Committee can see no justification whatsoever for a corporation using its assets to influence the market quotation of its own shares. Until recently, the practice of corporations either trading in their own stock or reacquiring substantial amounts of their outstanding stock was unusual." (N. Y. Times, Dec. 28, 1933, pp. 29, 31; quoted in Journal of Accountancy, July 1938, p. 19).

<sup>4</sup> See Nussbaum, *Acquisition by a Corporation of Its Own Shares*, 35 Columbia Law Review 971, 976. The leading English case is *Trevor v. Whitworth*, 12 A. C. 409; see also Companies Act of 1929, 19 & 20 Geo. 5, c. 23, sec. 45.

although national banks are prohibited from purchasing their own shares (12 U. S. C., Sec. 83), the laws of the States with some exceptions permit corporations to engage in the practice. That being so, it is doubtless desirable that conservative accounting practice be employed as a restraint on the corporation and as a helpful guide to creditors and investors.\*

The resulting divergence between recommended accounting practice on the one hand and the ordinary or statutory concept of income on the other, with specific reference to sales of treasury stock, is strikingly disclosed in a recent article by the Chairman of the Committee on Accounting Procedure of the American Institute on Accountants. In supporting the recommendation that profits from the sale of treasury stock not be treated as income in the corporate accounts, the author states:\*

The problem of the accountant is primarily to present accounts in the manner in

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\* In discussing possible methods of treating treasury shares on the corporate books, Finney, *Principles of Accounting*, (1937), Vol. 1, p. 88, states:

"The proper treatment of premiums and discounts will depend upon the answer to the following questions: (1) Is there any desire to distinguish between operating profits (by crediting them to surplus) and extraneous profits on treasury stock transactions (by crediting them to capital surplus or to some other special account)? (2) Does the law of the state of incorporation permit the payment of dividend from discounts on the purchase of treasury stock before such discounts are realized by the resale of the stock at a price in excess of cost?"

\* George O. May, *Recent Opinions on Dealings in Treasury Stock*, *Journal of Accountancy*, July 1938, pp. 17, 20.

which they will be most helpful for the legitimate purposes for which they are designed.

\* \* \* I believe that what we now call the income account should not include either profits or losses on dealings in treasury stock, or even profit from the redemption of bonds at a discount, or profits or losses on the sale of capital assets, except in so far as the last mentioned may represent a re-determination of provisions for depreciation or depletion.

It will be observed that along with profits from dealings in treasury stock there are here grouped for accounting purposes two classes of profit that are beyond question income under the Revenue Acts: profit from the redemption of bonds at a discount (*United States v. Kirby Lumber Co.*, 284 U. S. 1) and profits on the sale of capital assets (*Merchants Loan & Trust Co. v. Smietanka*, 255 U. S. 509). It has been suggested, with a good deal of force, that with respect both to profits from the sale of capital assets and profits from the sale of treasury stock, recognition of the essential character of the profits as income can be reconciled with desirable accounting practice by crediting the profit to earned surplus and immediately transferring it to capital surplus.<sup>7</sup> However this may be, the passage quoted above should be enough to demonstrate that if the profits involved in the present case are not to be regarded as income under the Revenue Acts, something more is needed than the recom-

<sup>7</sup> R. H. Montgomery, *Dealings in Treasury Stock*, Journal of Accountancy, June 1938, p. 466.

mentation of a school of accountants that the profits ought to be placed in a capital account.

It is submitted, therefore, that the gain realized by respondent from dealing in its own shares was income within the constitutional and statutory meaning of the term. It remains to consider the bearing of the regulations on the question.

## II

REGULATIONS 74, AS AMENDED, IN TERMS TREATS THE GAIN HERE INVOLVED AS INCOME, AND THERE IS NO REASON TO DENY APPLICATION TO THOSE REGULATIONS

As amended by T. D. 4430, approved May 2, 1934, *infra*, p. 52, Article 66 of Regulations 75, approved February 15, 1929, reads as follows:

Articles 543 of Regulations 65, approved October 6, 1924, and Regulations 69, approved August 28, 1926, and articles 66 of Regulations 74, approved February 15, 1929, and Regulations 77, approved February 10, 1933, are hereby amended to read as follows:

*Acquisition or disposition by a corporation of its own capital stock.*—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives

rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of applicable statutes.

\* \* \* \*

It is not open to question that this regulation applies in terms to facts such as those here involved, and in terms governs pending proceedings involving the year here in question. The Board and the court below so understood, and respondent presumably does not take issue on this point. And if our argument in Point I, *supra*, is sound, the regulation in its amended form interprets correctly the constitutional and statutory definition of income. The remaining question is whether the intention that the regulation should apply is to be given effect. We maintain that it should, for the reasons (1) that Congress has given express au-

thority in the Revenue Acts to make amended regulations thus effective, and (2) that there is no basis here for implying a Congressional intent to the contrary, particularly in view of the nature of the regulation involved.

The duty is vested in the Commissioner, with the approval of the Secretary of the Treasury, to "prescribe and publish all needful rules and regulations for the enforcement of" the income tax law. See, *e. g.*, Section 62, Revenue Act of 1928, *infra*, p. 51. The power to amend regulations is, of course, contained in the general grant; and at least as far back as 1921 Congress made it plain that amended regulations should be applied, in general, without limiting their application to future transactions. This is quite plainly brought out in Section 1314 of the Act of 1921, *infra*, p. 52, entitled "Retroactive Regulations", which provided that the Commissioner might in his discretion, with the approval of the Secretary, apply an amended regulation "without retroactive effect", but only where the amendment was "not immediately occasioned or required by a decision of a court". General application of an amended regulation was thus to be the rule; merely prospective application was to be the exception. In the 1926 Act the same provision was repeated. Sec. 1108 (a). It was not until the Act of 1928, Sec. 605, *infra*, p. 51, that the discretion of the Commissioner was enlarged to permit him, with the approval of the Secretary, to apply an amended regulation without retroactive effect irrespective of the occasion for the amendment.

In insisting that effect be denied to the power thus expressly given to the Commissioner, the respondent points to the earlier Regulations and relies on the doctrine that reenactment of the statutory definition of net income while those Regulations were in force is persuasive evidence of Congressional approval of the Regulations. It is true that the earlier Regulations from 1918 to 1934 provided that "A corporation realizes no gain or loss from the purchase or sale of its own stock". See page 52, *infra*. It may be observed in passing that a still earlier Regulation, applicable to the Act of 1916, contained a provision like that in the present Regulations: "If such stock [Treasury stock] is resold at a price in excess of its cost upon repossession, such excess shall be returned as income for the year in which resold." Regulations 33 (Revised), Article 98, *infra*, p. 54.

More important, however, is the fact that the Regulations in their *present amended form* may also be deemed to have secured Congressional approval by virtue of the reenactment of the statutory provision in two succeeding Revenue Acts.\* Reenactments after the taxable year are as significant as a reenactment by the statute governing the taxable year. E. g., *Brewster v. Gage*, 280 U. S. 327, 337; *Burnet v. Thompson Oil & Gas Co.*, 283 U. S. 301, 307; *Reinecke v. Smith*, 289 U. S. 172, 175. And the doctrine of reenactment applies to Regulations in their amended form as well as to

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\* Revenue Acts of 1936 and 1938.

Regulations in an earlier form. *Murphy Oil Co. v. Burnet*, 287 U. S. 299, 307; *Morrissey v. Commissioner*, 296 U. S. 344, 355. If the doctrine of reenactment is to be controlling, it is necessary to make an artificial choice between implied approval of the earlier Regulations and implied approval of the amended Regulations. In this situation it is submitted that the choice should be determined by the express authority conferred by Congress on the Commissioner with respect to the amendment of Regulations.

More fundamentally, however, we believe that the argument of respondent based on the doctrine of reenactment rests on a misconception of that doctrine. We believe that the decisions announcing and applying the rule of reenactment were not intended to mean that the Commissioner is powerless to reexamine and reformulate a Regulation of the character here involved, and that, as the Court in the *Squibb* case declared, an unsound Regulation interpreting a general statutory provision coextensive with the constitutional grant of power can be dislodged, if unsound, only by Congress. The number of income tax cases in which this Court has applied the rule of reenactment is impressive.\* But they do not touch the problem here involved.

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\* *Brewster v. Gage*, 280 U. S. 327, 337; *Poe v. Seaborn*, 282 U. S. 101, 116; *Burnet v. Thompson Oil & Gas Co.*, 283 U. S. 301, 307; *McCaughn v. Hershey Chocolate Co.*, 283 U. S. 488, 492; *United States v. Kirby Lumber Co.*, 284 U. S. 1, 3; *Old Colony R. Co. v. Commissioner*, 284 U. S. 552, 557; *Murphy Oil Co. v. Burnet*, 287 U. S. 299, 302, 307; *Massachusetts Mut. Life Ins. Co. v. United States*, 288 U. S. 269,

In most of the cases the Court sustained the position of the Government that an administrative construction should not be judicially disturbed, except for cogent reasons, where Congress has reenacted the statute without change. In a few of the cases the Court applied the rule of reenactment despite the Government's contention that for special reasons it was inapplicable.<sup>10</sup> But in none of the cases in which this Court applied the rule of reenactment did the Court do so to prevent the application of a subsequently amended Regulation. It is therefore respondent's position which is novel.

That respondent's is the novel position is made clear when it is recalled that this Court has in fact given effect to amended Regulations despite the reenactment of the statutory provisions while former Regulations were in force: *Morrissey v. Commissioner*, 296 U. S. 344; *Murphy Oil Co. v. Burnet*, 287 U. S. 299. The *Morrissey* case involved the meaning of the term "association." In determin-

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273; *United States v. Dakota-Montana Oil Co.*, 288 U. S. 459, 466; *Reinecke v. Smith*, 289 U. S. 172, 175; *Helvering v. Bliss*, 293 U. S. 144, 151; *Zellerbach Co. v. Helvering*, 293 U. S. 172, 178, 180; *Old Mission Co. v. Helvering*, 293 U. S. 289, 293; *Hartley v. Commissioner*, 295 U. S. 216, 220; *McFeely v. Commissioner*, 296 U. S. 102, 108; *Morrissey v. Commissioner*, 296 U. S. 344, 355; *United States v. Safety Car Heating Co.*, 297 U. S. 88, 95; *Lang v. Commissioner*, 304 U. S. 264, 270; *Helvering v. Winmill*, No. 11, present Term decided November 7, 1938. See, also, *Heiner v. Colonial Trust Co.*, 275 U. S. 232.

<sup>10</sup> In *Poe v. Seaborn* and *McFeely v. Commissioner*, *supra*, note 8, the Government urged that the statute had been amended, and, in *Helvering v. Bliss*, *supra*, note 8, that the administrative practice did not have the force of Regulations.

ing that meaning there was promulgated under the 1918 and 1921 Acts, following the decision in *Crocker v. Malley*, 249 U. S. 223, a Regulation declaring that if the beneficiaries of a business trust have a voice in the business it is an association, Regulations 45, 62, Article 1504. After the decision in *Hecht v. Malley*, 265 U. S. 144, the Treasury issued Regulations 65, Article 1504, as amended by T. D. 3748, to the effect that even in the absence of control by the beneficiaries, if trustees of an operating trust are associated like corporate directors for the purpose of a business enterprise, the trust constitutes an association. In holding that the subsequent Regulations were to be applied despite legislative reenactment while the earlier Regulations were in force, this Court stressed the necessary and appropriate range of administrative power to reexamine and reformulate its construction (296 U. S. at 354-355):

As the statute merely provided that the term "corporation" should include "associations," without further definition, the Treasury Department was authorized to supply rules for the enforcement of the Act within the permissible bounds of administrative construction. Nor can this authority be deemed to be so restricted that the regulations, once issued, could not later be clarified or enlarged so as to meet administrative exigencies or conform to judicial decision. Compare *Murphy Oil Co. v. Burnet*, 287 U. S. 299, 303-307. We find no ground

for the contention that by the enactment of the Revenue Act of 1924 the Department was limited to its previous regulations as to associations.

In the *Morrissey* case, as this Court pointed out (296 U. S. at 356), taxpayers who had filed returns as trusts for taxable years prior to 1925 under previous Regulations and rulings were relieved from the application of the amended Regulations by specific Congressional provision contained in Section 704 of the Revenue Act of 1928. In the *Murphy Oil Co.* case, cited in the *Morrissey* opinion, no such Congressional exemption was given, and the Regulations as amended in 1926 were held to govern the allowance of depletion in respect of royalties received in 1919 and 1920, governed by the Revenue Act of 1918. The validity of the original Regulations was not discussed by the Court. It is apparent that in the *Murphy Oil Co.* case the application of amended Regulations was made to transactions antedating the amendments by a greater period than that existing in the case at bar.

As the Regulations here involved are interpretive of a general statutory provision intended to be declaratory of constitutional power, the authority to reexamine and reformulate the Regulations is exercised with particular appropriateness; and, by the same token, the doctrine of reenactment loses much of its force. Here the general language contained in Section 22 of the Act is, as has been shown above, an attempt by Congress to restate a grant of power found in the Constitution. The Commis-

sioner has sought merely to explain further the constitutional and statutory grant. In so doing he performs essentially the function of a judicial agency; and it is a characteristic of such a function that its exercise ordinarily governs transactions already consummated which are the subject of pending controversy. Where the interpretive function entails a modification or overruling of prior pronouncements, the effect is enhanced. In those instances, for example, where this Court has modified or overruled precedents involving constitutional questions under the tax laws, the later view, deemed to be the sounder one, governs the pending controversy and prior transactions which are still open to question, in the absence of administrative or Congressional exemption. Compare *Gerhardt v. Commissioner*, 304 U. S. 405, rehearing denied, October 10, 1938; *Helvering v. Mountain Producers Corp.*, 303 U. S. 376. The analogy to judicial decision has been invoked by this Court to permit a retroactive correction of a legislative regulation—one which prescribes a rule implementing the statute. *Manhattan Co. v. Commissioner*, 297 U. S. 129, 135. Cf. *Titworth v. Commissioner*, 73 F. (2d) 385 (C. C. A. 3d). The analogy is even more persuasive in the case of an interpretive regulation, and most persuasive in the case of a regulation seeking to interpret constitutional power. No good reason is apparent why the Commissioner may not take the initiative in reviewing prior interpretations instead of calling on the courts to make the appropriate change without a formal change by

the Commissioner. The intervening reenactment of the general provision in Section 22 cannot be taken, it is submitted, as Congressional approval of what would otherwise be regarded as untenable constitutional doctrine. This is so because, as was said by this Court in *Helvering v. Powers*, 293 U. S. 214, 224, concerning regulations intended to interpret the constitutional doctrine of intergovernmental immunity:

\* \* \* the Treasury Department could not by its regulation either limit the provisions of the statute or define the boundaries of their constitutional application.

See also *Helvering v. Gowran*, 302 U. S. 238, 244 note; *Koshland v. Helvering*, 298 U. S. 441.

In summary, the Commissioner was expressly vested by Congress with power to amend the Regulations; and the intervening reenactment of the general definition of gross income in the Revenue Acts cannot be deemed an implied revocation of the power, particularly in view of the reenactment of the statutory definition subsequent to the amendment, the interpretative character of the Regulation, and the fact that it is addressed to a matter of the constitutional power of Congress itself.

Respondent's attack on the amended Regulation is thus necessarily a challenge of the propriety of the exercise by the Commissioner of discretion vested in him. It can be agreed that long-standing Regulations ought not lightly to be disturbed, as a

matter of administrative practice, except for substantial cause. But if it were true that undue hardship resulted from the exercise of the amending power, the remedy lies with Congress, as in the case of remedial legislation following upon judicial modification of a prior doctrine. Compare *Morrissey v. Commissioner*, 296 U. S. 344, 356. The Commissioner in the first instance, and then Congress, can take into account all material considerations in determining whether disproportionate hardship will result, as for example whether the early Regulations were themselves not wholly clear and whether the transactions affected were of the kind entered into with a substantial view to the question of tax liability.

In the present case, it should be emphasized, there were important considerations making the amendment reasonable and appropriate. The earlier Regulations did not deal specifically with the trafficking by a corporation in its own shares; their language was general, but the context indicated that dealings in a corporation's own stock as in the stock of another were not covered with particularity. This was recognized in *Dorsey Co. v. Commissioner*, 76 F. (2d) 339, 340, per Sibley, J.:

The point of law dealt with by the Board is whether the transaction was controlled by the last sentence of Regulation 74, Art. 66: "A corporation realizes no gain or loss from the purchase or sale of its own stock."

A reading of the whole Regulation, which had existed at least since 1918, shows that it referred mainly to the original sale of the capital stock and to stock turned back by stockholders to be resold to raise more capital. It was amended in 1934 by T. D. 4430 to distinguish clearly between original capital transactions and ordinary commercial dealings in its own stock as in that of another corporation.

Furthermore, as has been explained above (pages 27 to 30), the amendment was occasioned by a series of decisions of Circuit Courts of Appeals which indicated that in their then form the language of the Regulations was too broad. The court below adverted to the fact that it was the decision in the *S. A. Woods Co.* case, *supra*, that led to the promulgation of the amended Regulation and furnished the model for its language (R. 76). Moreover, the result of the amendment, as the facts of the present case show, is not simply to tax gains, but to allow losses as well, on a corporation's dealing in its shares.

In these circumstances, we submit, the Commissioner properly discharged his duty in amending the Regulations, leaving for the courts the question whether in its revised form the Regulation is a sound interpretation of the concept of income, and to Congress the question whether any class of taxpayers is entitled to exemption from its operation.

## CONCLUSION

For the foregoing reasons, it is submitted that the judgment of the court below should be reversed and that of the Board of Tax Appeals affirmed.

Respectfully submitted,

ROBERT H. JACKSON,

*Solicitor General.*

JAMES W. MORRIS,

*Assistant Attorney General.*

J. LOUIS MONARCH,

PAUL A. FREUND,

MORTON K. ROTHSCHILD,

*Special Assistants to the Attorney General.*

<sup>and</sup> HAROLD LEVENTHAL,

*Attorney.*

DECEMBER 1938.

## APPENDIX

### STATUTE AND OTHER AUTHORITIES INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

#### SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

\* \* \* \* \*

#### SEC. 62. RULES AND REGULATIONS.

The Commissioner, with the approval of the Secretary, shall prescribe and publish all needful rules and regulations for the enforcement of this title.

\* \* \* \* \*

#### SEC. 605. RETROACTIVE REGULATIONS.

Section 1108 (a) of the Revenue Act of 1926 is amended to read as follows:

"SEC. 1108. (a) In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect." (U. S. C., Title 26, Sec. 1691.)

### Revenue Act of 1921, Retroactive Regulations:

SEC. 1314. That in case a regulation or Treasury decision relating to the internal-revenue laws made by the Commissioner or the Secretary, or by the Commissioner with the approval of the Secretary, is reversed by a subsequent regulation or Treasury decision, and such reversal is not immediately occasioned or required by a decision of a court of competent jurisdiction, such subsequent regulation or Treasury decision may, in the discretion of the Commissioner, with the approval of the Secretary, be applied without retroactive effect.

### Treasury Regulations 74, relating to the Revenue Act of 1928:

ART. 66. *Sale by corporation of its capital stock.*—The proceeds from the original sale by a corporation of its shares of capital stock, whether such proceeds are in excess of or less than the par value of the stock issued, constitute the capital of the company. If the stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount is not a loss deductible from gross income. If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the shareholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock. (See article 176.)

Treasury Decision 4430, approved May 2, 1934,  
XIII-1 Cumulative Bulletin 36:

ARTICLE 66: Sale by corpo- XIII-20-6792  
ration of its capital T. D. 4430  
stock.

(Also Section 23 (i), Article 176.)

#### INCOME TAX.

Acquisition or disposition by a  
corporation of its own capital stock.

Articles 543 and 563, Regulations  
65 and 69, and articles 66 and 176,  
Regulations 74 and 77, amended.

TREASURY DEPARTMENT,  
OFFICE OF COMMISSIONER  
OF INTERNAL REVENUE,  
Washington, D. C.

*To Collectors of Internal Revenue and  
Others Concerned:*

Articles 543 of Regulations 65, approved  
October 6, 1924, and Regulations 69, ap-  
proved August 28, 1926, and articles 66 of  
Regulations 74, approved February 15, 1929,  
and Regulations 77, approved February 10,  
1933, are hereby amended to read as follows:

*Acquisition or disposition by a corpora-  
tion of its own capital stock.*—Whether the  
acquisition or disposition by a corporation  
of shares of its own capital stock gives rise  
to taxable gain or deductible loss depends  
upon the real nature of the transaction,  
which is to be ascertained from all its facts  
and circumstances. The receipt by a corpo-  
ration of the subscription price of shares of  
its capital stock upon their original issuance  
gives rise to neither taxable gain nor deduct-  
ible loss, whether the subscription or issue  
price be in excess of, or less than, the par  
or stated value of such stock.

But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of applicable statutes.

Articles 563 of Regulations 65, approved October 6, 1924, and Regulations 69, approved August 28, 1926, are hereby amended by striking out the first and second sentences thereof, by substituting the words "a corporation" in place of the second word in the third sentences of those articles, and by adding the following sentence to those articles:

As to the acquisition or disposition by a corporation of its own capital stock, see article 543.

Article 176 of Regulations 74, approved February 15, 1929, is hereby amended by omitting the first and second sentences thereof, by substituting the words "a corporation" in place of the second word in the third sentence of this article, and by adding the following sentence to this article:

As to the acquisition or disposition by a corporation of its own capital stock, see article 66.

Article 176 of Regulations 77, approved February 10, 1933, is hereby amended by omitting the first and second sentences thereof, and by adding the following sentence to this article:

As to the acquisition or disposition by a corporation of its own capital stock, see article 66.

GUY T. HELVERING,  
*Commissioner of Internal Revenue.*

Approved May 2, 1934.

H. MORGENTHAU, Jr.,  
*Secretary of the Treasury.*

Treasury Regulations 33 (Revised), relating to the Revenue Act of 1916:

ART. 98. *Treasury stock—When taxable.*—Treasury stock, wherever and whenever that term is used in connection with the accounts of the corporation or for income-tax purposes, will be held to mean stock which had been previously issued by the corporation and which had been repossessed by it through purchase or otherwise and then carried on its books as an asset. If such stock is resold at a price in excess of its cost upon repossession, such excess shall be returned as income for the year in which resold. Unissued stock, which had been retained by the corporation for the purpose of future sale, will not, for the purpose of the income tax, be considered "Treasury stock," and when sold no part of the proceeds of such sale will be considered taxable income. Nor will there be any deductible loss if such stock is sold at a price less than par.



No. 328

FILED

OCT 8 1938

CHARLES ELMORE CROPLEY  
CLERK

# **In the Supreme Court of the United States**

OCTOBER TERM, 1938.

GUY T. HELVERING, COMMISSIONER OF INTERNAL  
REVENUE, *Petitioner*,

*v.*

R. J. REYNOLDS TOBACCO COMPANY.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED  
STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH  
CIRCUIT.

**BRIEF FOR RESPONDENT IN OPPOSITION.**

✓ J. G. KÖRNER, JR.,  
404 Transportation Building,  
Washington, D. C.,  
*Attorney for Respondent.*

DAVID H. BLAIR,  
M. A. BRASWELL,  
404 Transportation Building,  
Washington, D. C.,  
*Of Counsel.*

September, 1938.



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# **In the Supreme Court of the United States**

**OCTOBER TERM, 1938.**

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**No. 328.**

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**GUY T. HELVERING, COMMISSIONER OF INTERNAL  
REVENUE, *Petitioner,***

*v.*

**R. J. REYNOLDS TOBACCO COMPANY.**

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**ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED  
STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH  
CIRCUIT.**

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**BRIEF FOR RESPONDENT IN OPPOSITION.**

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## **OPINIONS BELOW.**

The opinion of the Board of Tax Appeals (R. 21) is reported in 35 B. T. A. 949. The opinion of the Circuit Court of Appeals (R. 108), reversing the Board, is reported in 97 F. (2d) 302. The judgment of the Circuit Court of Appeals was entered June 6, 1938 (R. 116).

## **QUESTION PRESENTED.**

The question here presented is not the abstract question of whether this case is governed by the provisions of one regulation or another.

The question is whether a tenable statutory construction applied for approximately 25 years with the repeated affirmation of Regulations, Decisions and Rulings of the Department, by Board and Court decisions, and by repeated reenactments of the statute, has the force and effect of law; and whether the Court below correctly decided that, under those circumstances, and under the

rule of this Court, such statutory construction should not be overthrown.

It is respectfully submitted that a mere reading of the instant petition does not clearly convey that the Commissioner is asking that a construction placed upon a statutory definition (general in its terms) by the Treasury Department and applied over a period of approximately 25 years, shall be held invalid, void, untenable, and unsupportable on any reasonable basis.

The Court below found and held that the said long continued construction has a reasonable basis to support it, and that it has the support of numerous Board decisions, court decisions, and text authorities. The Court below also found and held that a different construction would likewise be tenable. Under these circumstances the Court below applied the rule laid down by this Court to govern such cases, and sustained the long continued construction placed upon the statute by the Treasury Department. The Court below further held that since the departmental construction had for many years received the affirmation of the Board of Tax Appeals and of the Courts, and had received the sanction of Congress in five successive carefully considered revenue acts, such construction is controlling under the circumstances of this case.

The question therefore is whether the Court below was correct in following the rule of this Court applicable in such circumstances.

#### HOW THE ISSUE AROSE.

This was a petition to the Circuit Court of Appeals for the Fourth Circuit to review an order of the Board of Tax Appeals finding a deficiency in income tax for the year 1929, in the amount of \$37,865.62. The issue arose in this way:

The Commissioner determined a deficiency on a transaction totally unrelated to the transaction here in question, and mailed deficiency notice on April 3, 1933. He did not determine that the instant transaction was taxable and

made no determination of deficiency relative thereto. Taxpayer filed petition in the Board of Tax Appeals on May 4, 1933. Answer was filed on June 27, 1933. Thereafter the cause was at issue for approximately three years, during which time the parties worked out an agreement and settlement of the only issue in the case. Then, on February 15, 1936, the Commissioner filed an amended answer in which he pleaded in effect that the Regulations in force and effect in 1929, and under which taxpayer had made the instant transaction, were erroneous and that the taxpayer had realized taxable income from said instant transactions in 1929. Taxpayer filed reply to said amended answer on March 14, 1936, and pleaded that the transactions in question had been made under and pursuant to the provisions of the Revenue Act of 1928, and the Regulations duly promulgated thereunder, and that the construction placed upon the statute by Departmental Regulations, Decisions and Rulings, and by Board and Court decisions, had continued for many years, and that during that period the revenue act had been repeatedly reenacted without change. Taxpayer pleaded the rule of this Court applicable under such circumstances as a complete bar to recovery of an additional deficiency arising by reason of the instant transactions. The petitioner further pleaded that the said construction was a sound construction and that the transactions in question were not taxable.

The Board found for the Commissioner. The taxpayer sought review in the Circuit Court of Appeals for the Fourth Circuit. That Court reversed the Board and held that the case is governed by the doctrine and rule of this Court that if a statute is reasonably susceptible of two constructions, its reenactment, after a construction by responsible officials has been long maintained, amounts to a legislative sanction of that construction.

## STATEMENT.

The facts, substantially as found by the Board of Tax Appeals (R. 22-30) are set out in the instant petition and need not be fully restated here. The facts as found by the Court below are set out at R. 109-112. The facts are not in dispute.<sup>1</sup> They may be summarized as follows:

Taxpayer corporation had issued its stock for cash. Thereafter it reacquired certain shares of its own stock for cash. Such acquisition was not pursuant to any contract agreement. Such stock was later reissued for cash, to persons desiring to acquire stock of the company. The original certificates were cancelled and new certificates issued.

The acquisition and reissue of such stock was effected for the purpose of protecting and preserving (1) the reputation of the company, (2) the reputation of the company's products and brands, and (3) the reputation of the company's stock. Each such transaction was made by the company under conditions which necessitated such action and under the necessity of protecting the company's business from a threatened peril (R. mid. 26, mid. 27, mid. 81, 82, top 83, top 84, mid. 86). The company acquired none of this stock as a medium of payment in any transaction in which the company sold an asset or a commodity (R. top 92). The company's charter did not authorize it to deal in stocks of any kind. The company did not believe that these transactions constituted dealing in stock (R. mid. 88). The company has never dealt in corporate shares (R. mid. 91). The sole purpose in the instant transactions was to protect the company and its business in a special situation (R. top 88, mid. 90, mid. 86). The reissuance of the stock here involved occurred in 1929. Some of the stock so reissued in 1929 had been acquired by the company in 1921 and

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<sup>1</sup> Taxpayer would, however, call attention to a minor error occurring in the first line of page 10 of the petition herein, and in the 2d paragraph of R. 27, where the date mentioned should read "September 18, 1929," instead of "December 18, 1929." See Record near top page 85.

had been held by the company as treasury stock since that time. The remaining shares so reissued had been acquired earlier in the year 1929 (R. 110-111).

The company made said transactions in view of departmental regulations, rulings and decisions, then in force and effect, and in the belief that the departmental regulations were correct and controlling (R. 29, 111, bot. 80).

Under the Revenue Act of 1918, the Department promulgated Regulations 45, Art. 542, holding that where a corporation acquires stock previously issued by it, the sale of such stock constitutes a capital transaction and the proceeds of such sale constitutes capital and not income of the corporation, and that a corporation realizes no gain or loss from the purchase or sale of its own stock. That construction was applied by Departmental Rulings to all prior Revenue Acts (the Revenue Acts of 1913 and 1916) and to the Corporation Tax Act of 1909.

That Regulation was continued without change down to 1934. During that period the Department issued many rulings and decisions supporting and reaffirming that regulation. The Commissioner repeatedly defended that regulation before the Board of Tax Appeals. The Board repeatedly affirmed it by published decisions. The Regulation received the approval of the Circuit Courts of Appeals.

In 1929 these regulations, rulings and decisions were in force and effect and were at that time being continuously applied and vigorously defended by the Department,<sup>1</sup> and in 1929 the taxpayer made its transactions. A more detailed chronology of the history of the long continued construction will be set forth hereinafter.

<sup>1</sup> In his brief filed in the Board in 1926, in *Emerson Electric Co.*, 3 B. T. A. 932, the Commissioner cited and quoted Art. 542 of Reg. 45 and argued (as he had done in all the previous cases) that the Regulation was not contrary to the intent and purpose of the Revenue Act's definition of income, but that it was fully in accord therewith; and then said: "This regulation has been applied and followed for so long as to become *stare decisis* under the principle announced by the Supreme Court in the *Flannery* case."

In 1934, the Department issued *Treasury Decision 4430*, C. B. XIII-1, 36. That was after the established rule had been applied for about 25 years, by rulings and decisions of the Department and about 16 years after it had remained continuously in the Regulations, and about 5 years after the taxpayer had made its instant transactions. The effect of *Treasury Decision 4430* was to declare invalid and of no effect all the Regulations, Rulings and Decisions above referred to. The Commissioner invoked this new ruling in the instant case some 3 years after the instant cause was at issue in the Board.

In the instant case the position of the Commissioner is that: (1) the long continued regulations, rulings and decisions of the Bureau, the Board, and the Courts, are null and void and of no effect, (2) that they are and have always been plainly and obviously wrong and untenable and without any reason to support them, (3) that the repeated reenactments of the statute, without change, give no support to them, and (4) that they were invalid and void in 1929 and in all the years during which they were in effect and while they were being enforced by the Department.

#### STATUTES AND OTHER AUTHORITIES INVOLVED.

These are printed in the Appendix, *infra*, pp. 24-26.

#### ARGUMENT.

It is submitted that the Court below correctly applied the rule, under the well established doctrine of this Court, that when a statute is reasonably susceptible of two constructions, its repeated reenactment in light of an interpretative ruling by responsible officials, amounts to a legislative sanction of the course pursued, and especially when the construction has been long maintained and several reenactments of the statutory language have taken place (R. 115). The Court below was correct in reversing the Board.

1. *The Decision of the Court Below Does Not Sustain a Contention which Exempts Income from Taxation.*

The decision below does not purport to uphold an exemption from taxation, as suggested by the instant petition (Pet. 17-18). The decision is specifically grounded on the proposition that there is reason and authority to support the long continued construction put upon the statute, and that accordingly the duty of the Court was clear in applying literally the mandate of this Court applicable under the circumstances.

The long continued rule of construction was that in transactions of this kind no income could or did accrue to the corporation,<sup>1</sup> and that the sale by a corporation of its own reacquired stock constitutes a capital transaction and the proceeds of such sale do not constitute income because a corporation realizes no gain or loss on the purchase or sale of its own stock.<sup>2</sup> It is thus apparent that the long continued construction is not one which *exempts* a taxpayer's gain from taxation.

2. *The Decision of the Court Below is Correct.*

It should first be clearly understood exactly what the Court below decided. It decided only that, as between two reasonable constructions of the statute, that construction which has received long and continuous application by responsible officials, and in light of which several reenactments of the statute have taken place, must be held to have received legislative sanction.

Three main elements appear in the decision: (1) the duration of the construction, (2) the presence of reason to support it, and (3) the repeated reenactments of the statute, without change, during the continuance of that construction.

<sup>1</sup> *Low Opinion* 296, 5 C. B. top 210, issued under the 1913 Act; A. R. R. 693, 5 C. B. 207, bot. 209.

<sup>2</sup> Reg. 45, Art. 542; Reg. 62, Art. 543; Reg. 65, Art. 543; Reg. 69, Art. 543; Reg. 74, Art. 66; Reg. 77, Art. 66.

The history and long duration of the construction will be set forth in chronological form showing its long continued application. That there is authority and reason to support it is shown by the numerous decisions rendered in support of it, over a long period of years, by many responsible departmental officials, by the Board of Tax Appeals, and by the Courts. The reenactments of the revenue act speak for themselves. The history of the construction, the support it has had in many considered opinions and decisions, and the reenactments of the statute will be here briefly, but by no means exhaustively, reviewed.

Very early in the history of income taxation the construction of the general statutory definition of income, as applied to transactions of the kind here involved, came under consideration by the departmental officials charged with the duty of administering the statute and promulgating regulations pursuant thereto. The then outstanding authorities on the subject were in general agreement that reacquired, or treasury, stock was not property, or a commodity, in the hands of the issuing corporation; that the issue of such stock has the same effect as the original issue of such stock; and that the issuance of such stock was a capital issue and constituted a capital transaction resulting in neither gain nor loss. Among such authorities were the many text writers on the subject whose views were to the same effect and have, without substantial variance, prevailed from that day down to the present.

Among such authorities are the following:

Esquerre, "*Applied Theory of Accounts*." (See 2 C. B. 211.)

Dickinson, "*Accounting Practice & Procedure*," 130, 132.

Paton, "*Accountants' Hand Book*, 931-2, 980-1.

Wildman and Powell, "*Capital Stock Without Par Value*," 93-4.

Sunley and Pinkerton, "*Corporation Accounting*," 121.

Kester, "*Accounting Theory and Practice*," 17.

Esquerre, "*Practical Accounting Problems*," Part II, 1922, 6-81.

Hills, "*Stated Capital and Treasury Shares*," *Journal of Accountancy*, Vol. 57, Jan. to June, 1934, 202, 212, 213.

Marple, "*Treasury Stock*," *Journal of Accountancy*, Vol. 57, Jan. to June, 1934, 257, 262-3.

Holmes, "*Federal Taxes*," (6th Ed.) p. 236.

*Morawetz on Private Corporations* (2d Ed.), Vol. 1, sec. 112, p. 109.

The Treasury Department gave careful consideration to this question in light of existing authorities, and ruled that if a corporation reacquires shares of its own stock previously issued by it, and later sells and reissues such stock, such sale constitutes a capital transaction and the proceeds of the sale constitute capital and not income to the corporation.<sup>1</sup> This construction was later adopted as a departmental *Regulation* with the approval of the Secretary (Regulations 45, Art. 542, promulgated under the Revenue Act of 1918). Soon thereafter, the Department promulgated *Law Opinion 1035*, 2 C. B. 132, approving the rule and stating that it applied with equal force to the Revenue Act of 1916 and to the Corporation Tax Act of 1909. Soon after that the Department promulgated ruling *A. R. R. 693*, 5 C. B. 207, 209, stating that the provisions of the Regulation applied to revenue acts prior to the Revenue Act of 1918.

From that time forward, and down to 1934, the above principles were affirmed and reaffirmed year after year, by repeated Departmental Rulings and by continuous inclusion in the Departmental Regulations promulgated under each succeeding Revenue Act—each Revenue Act being reenacted in light of such continued construction, and in each instance without change. The chronology of these Departmental Rulings and Regulations is as follows:

<sup>1</sup> The statement of the principle is clearly and concisely summarized by Judge Learned Hand in *Borg v. International Silver Co.*, 11 F. (2d) 147, 150, as set forth in Appendix, pages 27, 28.

*Law Opinion 296*, 5 C. B. top p. 210.<sup>1</sup>

*Law Opinion 426*, 5 C. B. mid. p. 210.<sup>2</sup>

1919 *Revenue Act of 1918*.

1920 *Treasury Regulations 45*, Art. 542 and 563, pursuant to 1918 Act.

1920 *Law Opinion 1035*, 2 C. B. 132.

1920 *Law Opinion 1035* (Revised), 3 C. B. 160, 162.

1921 *Treasury Decision 3206*, 23 T. D. 763.

1921 *A. R. R. 693*, 5 C. B. 207.

1921 *Revenue Act of 1921*.

1922 *Treasury Decision 3295*, 24 T. D. 207, promulgating *Treasury Regulations 62*, Art. 543 and 563, pursuant to 1921 Act.

1922 *I. T. 1198*, C. B. I-1, 275.

1922 *A. R. R. 799*, C. B. I-1, 374.

1923 *I. T. 1736*, C. B. II-2, 274.

1923 *I. T. 1802*, C. B. II-2, 267.

1924 *Revenue Act of 1924*.

1924 *Treasury Decision 3640*, 26 T. D. 745, promulgating *Treasury Regulations 65*, Art. 543 and 563, pursuant to 1924 Act.

1924 *S. M. 2205*, C. B. III-2, 244.

1924 *A. R. R. 8159*, C. B. III-2, 256.

1926 *Revenue Act of 1926*.

1926 *Treasury Regulations 69*, Art. 543 and 563, pursuant to 1926 Act.

1928 *Revenue Act of 1928*.

1928 *Treasury Regulations 74*, Arts. 66 and 176, pursuant to 1928 Act.

1932 *Revenue Act of 1932*.

1932 *Treasury Regulations 77*, Art. 66 and 176, pursuant to 1932 Act.

1934 *Revenue Act of 1934*.

From the foregoing it is seen that the rule was applied by

<sup>1</sup> The date of L. O. 296 is not given but it is stated that it was issued under the Revenue Act of 1913.

<sup>2</sup> The date of L. O. 426 is not given but it is stated that it was issued under the Revenue Act of 1916.

the Treasury Department through Rulings, Decisions and Regulations from 1909 down to and including the time of the passage of the Revenue Act of 1934—a period of approximately 25 years. During that long period of years the rule was made the subject of consideration, ruling, decision and affirmation by not less than seven Solicitors and General Counsels, six Commissioners of Internal Revenue, and five Secretaries of the Treasury.

In the meantime, however, the Board of Tax Appeals had come into existence in 1924. The Commissioner repeatedly argued before the Board in support of the Departmental construction,<sup>1</sup> and the Board repeatedly affirmed it. The Board held in *Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803 (1925) that where a corporation sold shares of its own stock which it had previously reacquired, no loss occurred to the corporation. That decision was followed by the Board and applied under varying states of fact:

1925 *Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803.

1925 *Cooperative Furniture Co.*, 2 B. T. A. 165.

1925 *Atlantic Carton Co.*, 2 B. T. A. 380.

1926 *Emerson Electric Co.*, 3 B. T. A. 932.<sup>1</sup>

1926 *Illinois Rural Credit Ass'n*, 3 B. T. A. 1178.

1926 *Hutchins Lumber & Storage Co.*, 4 B. T. A. 705.

1926 *Farmers Deposit National Bank*, 5 B. T. A. 520.

1926 *H. S. Crocker Co.*, 5 B. T. A. 537, 541.

1926. *Interurban Construction Co.*, 5 B. T. A. 529.

1926 *Liberty Agency Co.*, 5 B. T. A. 778.

1927 *Simmons Company*, 8 B. T. A. 631, 645; aff'd 33 F. (2d) 75 (CCA 1); cert. denied 280 U. S. 588.

1928 *Union Trust Co.*, 12 B. T. A. 688, 690.

1929 *105 West 55th Street, Inc.*, 15 B. T. A. 210, 213; aff'd 42 F. (2d) 849 (CCA 2).

1929 *Riggs National Bank*, 17 B. T. A. 615, 618; aff'd 57 F. (2d) 980 (CCA 4).

<sup>1</sup> See footnote, bot. p. 5, *supra*.

1930 *J. H. Johnson*, 19 B. T. A. 840, 847; aff'd 56 F. (2d) 58 (CCA 5); cert. denied 286 U. S. 551.

1930 *American Cigar Co.*, 21 B. T. A. 464, 495; aff'd 66 F. (2d) 425 (CCA 2); cert. denied 286 U. S. 551.

1930 *Inland Finance Co.*, 23 B. T. A. 199; aff'd 63 F. (2d) 886 (CCA 9).

1932 *Carter Hotel Co.*, 25 B. T. A. 933; aff'd 67 F. (2d) 642 (CCA 4).

Thus it is seen that the rule was being urged by the Department in the Board and in the Courts over a long period of years; and that contemporaneously with the Departmental Regulations, and in accordance with Departmental Regulations, Decisions and Rulings, the Board and the Courts, over this same period of years, were giving affirmation and approbation to the rule.

In the same year (1925) in which the Board decided *Simmons & Hammond Mfg. Co.*, *supra*, the Second Circuit Court of Appeals decided *Borg v. International Silver Co.*, 11 F. (2d) 147, 150 (cited and quoted by the Court below at R. 113). In that decision the same rule and doctrine was upheld, viz., that transactions of this sort are capital and not income transactions.

The Seventh Circuit Court of Appeals in *Commissioner v. Van Camp Packing Co.*, 67 F. (2d) 596 (1933) stated that the rule is applicable in a case where the corporation acquires and sells shares of its own stock as distinguished from shares of another (and subsidiary) corporation.

It was in light of the above administrative and legislative history that the Court below made its decision. The Court found that two reasonable constructions might be put upon the section. The Court then followed literally the mandates of this Court that: "Possible doubts as to the proper construction of the language used should be resolved in the light of its administrative and legislative

history.” “If there were doubt as to the connotation of the term, and another meaning might be adopted, the fact of its use in a tax statute would incline the scale to the construction most favorable to the taxpayer.” “The Commissioner has heretofore administered the section upon this theory. \* \* \* The repetition of the definition without material change in the subsequent acts, including that of 1928, amounts to a confirmation of the administrative interpretation. There is nothing in the section, its history, or the administrative practice, to enlarge or alter the connotation commonly ascribed to the word ‘held.’” “It is especially objectionable that a construction of a statute favorable to the individual citizen should be changed in such manner as to become retroactive \* \* \*.” “\* \* \* the reenactment by Congress, without change, of a statute which had previously received long-continued executive construction, is an adoption by Congress of such construction.” “These provisions were retained, without substantial change, in the regulations promulgated under the 1924, 1926 and 1928 Acts. \* \* \* As §234 (a) (1) to which they pertain has been reenacted in several revenue acts, the regulation now has the force of law.” “This construction of those terms has been adhered to in the Internal Revenue Bureau for about ten years and it ought not to be disturbed now unless it be plainly wrong.”

The Court below applied each of the foregoing injunctions of this Court to the circumstances in this case and held that the long continued construction put upon the act was not null and void and without any reason to support it. The rationale of the Court below is thus stated (R. bot. 115):

<sup>1</sup> *McCaughn v. Hershey Chocolate Co.*, 283 U. S. 488, 492.

<sup>2</sup> *Old Colony R. Co. v. Com'r*, 284 U. S. 552, 561.

<sup>3</sup> *McFeely v. Helvering*, 296 U. S. 102, 108.

<sup>4</sup> *United States v. Alabama Great Southern R. Co.*, 142 U. S. 615, 622.

<sup>5</sup> *United States v. Cerecido Hermanos y Compania*, 209 U. S. 337, 339.

<sup>6</sup> *Old Mission P. Cement Co. v. Helvering*, 293 U. S. 289, 293-294.

<sup>7</sup> *Universal Battery Co. v. United States*, 281 U. S. 580, bot. 583.

Our path is therefore clear; for the rule is well settled that if a statute is reasonably susceptible of two constructions, its reenactment after an interpretative ruling by responsible officials amounts to a legislative sanction of the course pursued. Especially is this true when the construction has been long maintained and several reenactments of the language in dispute have taken place. The rule has been frequently applied in cases under the revenue acts when the statutory language is in general terms and susceptible of different interpretation as applied to the relevant facts; and in *Johnson v. Commissioner*, 56 F. (2d) 58, (C.C.A. 5) 1932, it was applied to the very regulation now under consideration as set out in Regulations 62, Article 543 relating to the Revenue Act of 1921.

As the basis for its said conclusion the Court found that for 16 years (1918 to 1934) the regulations and decisions of the Department, decisions of the Board, and decisions of the Courts supported the long continued construction, and that text writers have generally held to the same effect. The Court recited that neither interpretation of the act is without a reasonable basis, but that since the prevailing opinion had supported the construction for so many years, and that since, in light of such opinion, Congress had reenacted the definition in five successive carefully considered revenue acts, the long continued construction must be deemed to have legislative sanction.

*The Court below was correct in following the established rule of this Court in such circumstances. That rule is set forth in the following cases:*

*United States v. Alabama Great Southern R. Co.*,  
142 U. S. 615.

*United States v. Finnell*, 185 U. S. 236.

*Copper Queen Consol. Min. Co. v. Arizona*, 206  
U. S. 474.

*United States v. Cerecido Hermanos y Compania*,  
209 U. S. 337.

*National Lead Co. v. United States*, 252 U. S. 140.

- United States v. Jackson*, 280 U. S. 183.  
*Brewster v. Gage*, 280 U. S. 327.  
*Luckenbach Steamship Co. v. United States*, 280 U. S. 173.  
*Universal Battery Co. v. United States*, 281 U. S. 580.  
*Fawcus Machine Co. v. United States*, 282 U. S. 375.  
*McCaughn v. Hershey Chocolate Co.*, 283 U. S. 488.  
*Old Colony R. Co. v. Commissioner*, 284 U. S. 552.  
*Murphy Oil Co. v. Burnet*, 287 U. S. 299.  
*Massachusetts Mutual L. Ins. Co. v. United States*, 288 U. S. 269.  
*Helvering v. Bliss*, 293 U. S. 144.  
*Old Mission P. Cement Co. v. Helvering*, 293 U. S. 289.  
*Hartley v. Commissioner*, 295 U. S. 216.  
*McFeely v. Helvering*, 296 U. S. 102.  
*Koshland v. Helvering*, 298 U. S. 441.  
*Helvering v. Minnesota Tea Co.*, 296 U. S. 378, 383-384.  
*Hassett v. Welch*, — U. S. —, 82 L. ed. — (Adv. Op. 575).

### 3. *There is No Real Conflict Below.*

The petition states that the decision below is in conflict with the decision in *First Chrold Corp. v. Commissioner*, 97 F. (2d) 22, and states that the Circuit Courts below reached conflicting results (Pet. mid. 16).

It is respectfully submitted that the alleged conflict is apparent and not real. The Third Circuit Court of Appeals approached the question by stating: "We treat the case as presenting but one question." The Court then stated the question to be whether or not a corporation realized a taxable profit when it acquired shares of its own stock and reissued them for a price above the acquisition price. The Court treated the case as one of first impression. The Court made no mention of the Regulations, existing since 1918, upon which the taxpayer relied in making its transaction. The Court made no

mention of the many Departmental Rulings and Decisions applying that regulation. The Court made no mention of the authorities, cases and decisions tending to show that there was reason, logic and authority to support that construction. The Court did not decide or hold that the old and long continued construction was clearly and obviously wrong and untenable.

That decision held only one thing. It held only that, viewed as a matter of first impression, shares of stock are *thought of* as property, because shares can be bought and sold; that a corporation may buy and sell its own shares as it does other kinds of property, in a *practical* sense; that in such case it ignores the fact that it is its own stock; that this is so because corporations are known to do it; that when a corporation buys and sells its own stock it constitutes an "as if" transaction, i. e., in such cases the corporation buys and sells them "*as if*" *they were not the corporation's own shares*. The Court concludes that this in no way affects the capital of the corporation because it is assumed that, if the shares were not the corporation's own shares, the transaction would be taxable, but since they *were* the corporation's own shares, they would, notwithstanding, be considered "*as if*" *they were not*. The Court cites no authority for its view. The Court, in effect, says that, as an abstract proposition of first impression, such a transaction ought to be taxed.

The *Fourth Circuit Court of Appeals* decides no such thing. The Court below says: "We do not undertake to say that the present regulations would not have been a correct interpretation of the statute, as applied to such facts as are now before us, if it had been promulgated in 1918." The Court below holds, in effect, that even though the Third Circuit's view be tenable, those views do not decide the instant issue because the long continued construction can not be overthrown and cast aside unless it be shown to be plainly wrong. The Third Circuit Court of Appeals did not find the long continued construction to be plainly wrong. It did not refer to it.

The two Circuit Courts are not in real conflict because they do not decide the same issue.

The Third Circuit Court of Appeals decided that a transaction was not a capital transaction but was a taxable sale of property; ignoring the administrative and legislative history showing that the opposite rule had become embedded in the statute. The Fourth Circuit Court of Appeals decided that the rule had become imbedded in the statute and that the question whether a similar transaction was a capital or an income transaction was not of controlling importance, albeit there was reason to support either view. The instant case was decided on the issue which is controlling under the circumstances. The Third Circuit Court of Appeals did not decide that issue. The Third Circuit Court decided that there is reason to support the contention that the transaction was an income and not a capital transaction. The Fourth Circuit Court did not deny that. The Fourth Circuit Court decided that there was likewise reason to support the long continued statutory construction. The Third Circuit Court made no decision as to that. The Fourth Circuit Court decided that under the circumstances the long continued statutory construction had the force and effect of law. The Third Circuit Court of Appeals did not discuss that issue.

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The instant petition refers to the decision of the Second Circuit Court of Appeals in *E. R. Squibb & Sons v. Helvering*, 98 F. (2d) 69, as bearing upon the point of conflict. Respondent herein is advised by counsel that the Second Circuit Court of Appeals has granted rehearing, and that such rehearing has not yet been had.

What has been said above applies equally to the decisions in the *Squibb case*, *supra*, and in the *First Chrold case*, *supra*. This is so because the Second Circuit Court of Appeals based its decision on precisely the same grounds as those on which the Fourth Circuit Court of Appeals

based its decision in the instant case. The Second Circuit Court stated: "But in any event it seems to us that the uniform interpretation, so long placed upon §22(a), 26 U. S. C. A. §22(a), by the regulations and confirmed by the inaction of Congress, was imbedded in the statute so deep that only legislation could dislodge it." The Court stated that it is unnecessary to say that no other interpretation could have been made. The Court discussed *arguendo* the corollary question of abstract taxability of the transaction and concluded that snares acquired and sold by the issuing corporation, for cash, at the market, are capital transactions. However, a reading of the decision shows that the *basis of the Court's decision* is the Supreme Court's rule applicable to the long continued construction of the statute. Thus it appears clear that the *Squibb case* decided an issue which was not discussed in the *First Chold case*.

The instant petition makes reference (p. 20) to a number of cases which have no relevancy here. In each and every one of these cases the taxpayer sold a physical asset—in one instance the sale was of a building in the city of Dallas; in another case it was "an ordinary sale of property"; in another it was the sale of an account receivable. In no one of those cases was there a sale of stock involved. In each case the sale of the asset was made at a taxable profit. Those cases held that such profit was not to be exempted from tax merely because the selling corporation accepted shares of its own stock as a medium, or partial medium, of payment.

#### 4. *The Instant Case Presents No Exception to the Established Rule of This Court.*

Sec. 22 (a) of the 1928 Act is a *general definition* of income. It is not proper to classify it as "ambiguous" or as "unambiguous." As in all such general statutory definitions it is the duty of the Department to indicate the method of its application to specific cases. This Court has

said that "where the statute merely expresses a general rule and invests the Secretary of the Treasury with authority to promulgate regulations," "a clarifying regulation or one indicating the method of its application to specific cases" will be given great weight by the courts.<sup>1</sup> This Court has also said that where the Department has long continued to administer a general definition by specific construction, such construction must not be altered unless the section, its history, and the administrative practice, shows it to be violative of the plain and unequivocal meaning of the statute.<sup>2</sup> This Court has held that possible doubts as to such construction must be reviewed in the light of its administrative and legislative history.<sup>3</sup>

Sec. 22 (a) being a "general" definition, the Secretary construed it under the power with which he was invested so to do. The foregoing rule of this Court is specifically applicable.

##### 5. *The Real Issue Presented Here.*

It is respectfully submitted that the instant petition does not express clearly the proposition that the Commissioner is seeking an opportunity to ask this Court to invalidate and declare void a statutory construction with a history well nigh unprecedented in income taxation. It is respectfully submitted that the petition shifts the emphasis from the important principle of statutory construction (controlling in this case) to the secondary (and non-controlling) question of whether the transaction in question is, abstractly, a capital transaction or an income transaction.

It may safely be said that at each term the Commissioner appears several times before this Court and insists

<sup>1</sup> *Koshland v. Helvering*, 298 U. S. 441, 447, 446. Cf: *Maryland Casualty Co. v. United States*, 251 U. S. 342, 349, 350.

<sup>2</sup> *McFeely v. Helvering*, 296 U. S. 102, 108.

<sup>3</sup> *McCaughan v. Hershey Chocolate Co.*, 283 U. S. 488, 492.

upon the rule that Departmental Regulations have the force and effect of law; that when such regulations have received repeated application by Departmental Rulings and Decisions, their force and effect becomes tantamount to law; that when the construction put upon a statute by Departmental Regulations, Rulings and Decisions, are repeatedly affirmed by the Board and the Courts, such construction must not be overthrown without the most cogent and weighty reasons; that when such long continued construction and continuous application of that construction has been followed by a reenactment of the statute without change, it thereby receives legislative sanction which gives it the effect of a statutory enactment; and that such construction may not be overthrown if any reason exists to support it.

It may also be safely said that in every business day of the year the Commissioner insists upon the application of this rule in the Department, in the Board, or in some court of this land. It is safe to assert that thousands of cases are decided each year, in the Department, in the Board, and in the Courts, upon the application of this rule.

This Court has repeatedly sustained the Commissioner and has applied constructions put upon the statute by the Department, which have had no such history as the present one. The office of the Commissioner is a unit. Consistency of position should, therefore, be expected of the Commissioner, because it is by the construction and interpretation put upon the statute by his Department that practically all tax controversies are governed, and it is his regulations and rulings which form the guide for all transactions made by taxpayers. If the Commissioner is to contend hereafter that Departmental Regulations are to have the force and effect of law, and that reliance is to be placed upon them by taxpayers and the courts for that reason, such contention would seem to lose much of its weight in light of his present contention that this long continued construction (supported by Board and Court decisions) is null and void and that it has been adminis-

tered and applied for these many years without any reason to support it.

6. *The Money Involved is Not Determinative.*

The petition states that there are six similar cases pending in the Board and at least eighteen in the Bureau. The taxpayer does not have the advantage of statistics but respectfully suggests to the Court the following:

For about 25 years the Commissioner administered this section under his rulings that the instant transactions were capital transactions and not income transactions. For 16 years of that time his Regulations so provided. During about 10 years of that period he maintained and defended that position in the Board of Tax Appeals and in the Courts, in a large number of cases. During that period the statute was repeatedly reenacted without change. Obviously every tax case in which this principle was applied was not made the subject of a published Departmental ruling or Board decision. It is reasonable to suggest, therefore, that his long continued construction has been applied to thousands of cases; that thousands of taxpayers have had their taxes adjusted by the Commissioner under those regulations and rulings; that other thousands of taxpayers made their returns in accordance with those regulations and no tax case arose upon them. The cases of all those thousands of taxpayers are now closed. By applying his construction over this long period of years the Commissioner has unquestionably collected vast amounts of money in taxes.

The Commissioner now seeks to apply retroactively an opposite rule. He seeks to apply such opposite rule retroactively to 1924. That is now a period of 14 years. His petition says there are now about 24 cases. This is an average of slightly less than two cases per year since 1924. It is respectfully submitted that this does not present to this Court a case of great national importance.

The retroactive change of construction contended for

by the Commissioner would violate a long established doctrine of this Court relative to uniformity of taxation. According to the petition herein a very negligible fraction of taxpayers' cases, which have arisen on this point since 1918, are now involved. Practically all of them are finally closed by the statute of limitations. It would be unjust and oppressive to the remaining few to apply a rule totally opposite to, and inconsistent with, the rule applied to practically all the similarly circumstanced taxpayers through all these years of the administration of the section in question.

The rule of this Court is well established that a construction of a statute must not be adopted which leads to unjust, oppressive or inconsistent results, and which does violence to the rule of uniformity of taxation of taxpayers similarly situated. *United States v. Kirby*, 7 Wall. 482, 486; *Ilfeld Co. v. Hernandez*, 292 U. S. 62, 68; *Savings and Loan Ass'n v. Topeka*, 20 Wall. 655, 22 L. ed. 455, 461; *Reagan v. Trust Co.*, 154 U. S. 362, 390; *Sioux City Bridge Co. v. Dakota County*, 260 U. S. 441 (by Mr. Justice Taft); *Ozawa v. United States*, 260 U. S. 178, 194. See also *Taylor v. L. & N. R. Co.*, 88 Fed. 350; *Railroad and Telephone Cos. v. Board*, 85 Fed. 302, bot. 307; *County of Santa Clara v. Railroad Co.*, 18 Fed. 385, 399; *Louisville & N. R. Co. v. Bosworth*, 230 Fed. 191, 209; *State v. Taylor*, 35 N. J. Law 184; *People ex rel. v. City of Chicago*, 152 Ill. 546, 552; *Supervisors v. Railroad Co.*, 44 Ill. 229; *Ex parte Bridge Co.*, 62 Ark. 461; *Com'rs of Inland Revenue v. Harrison*, L. R. 7 H. L. 1; *Lewis' Sutherland Statutory Construction*, Vol. 2 (2d Ed. 1904), sec. 489, p. 913.

In *Bingham v. United States*, 296 U. S. 211, this Court, quoting with approval from *Lewellyn v. Frick*, 268 U. S. 238, said:

This court applied the rule that acts of Congress are to be construed, if possible, so as to avoid grave doubts as to their constitutionality; and said that such doubts were avoided by construing the

statute as referring to transactions taking place after it was passed. In that connection we invoked the general principle "that the laws are not to be considered as applying to cases which arose before their passage" when to disregard it would be to impose an unexpected liability that, if known, might have been avoided by those concerned.

And in *United States v. Flannery*, 268 U. S. 98, this Court said that: "Decisions affecting the business interests of the country should not be disturbed except for the most cogent reasons." *National Bank v. Whitney*, 103 U. S. 99, 102.

The taxpayer respectfully submits that the desire of the Commissioner to invalidate retroactively his Regulations and Rulings of many years standing would result in unjust, oppressive, and inconsistent results and would do violence to the rule of uniformity of taxation; and that the Court below correctly applied the rule applicable to a long continued construction of the statute in light of which the statute was repeatedly reenacted without change.

### CONCLUSION.

The petition should be denied for the reasons above stated.

Respectfully submitted,

J. G. KÖRNER, JR.,  
404 Transportation Building,  
Washington, D. C.,  
*Attorney for Respondent.*

DAVID H. BLAIR,  
M. A. BRASWELL,  
404 Transportation Building,  
Washington, D. C.,  
*Of Counsel.*

September, 1938.

## APPENDIX.

## STATUTE AND OTHER AUTHORITIES INVOLVED.

Revenue Act of 1928, c. 852, 45 Stat. 791:

## SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

This provision was enacted in substantially the same language in the Revenue Act of 1913 and was thereafter so reenacted in the Revenue Acts of 1916, 1917, 1918, 1921, 1924, 1926 and 1928. The Revenue Act of 1928 is the controlling act in the instant case. Thereafter it was likewise so reenacted in the Revenue Acts of 1932 and 1934.

Treasury Regulations 74, relating to the Revenue Act of 1928:

ART. 66. *Sale by corporation of its capital stock.*—

The proceeds from the original sale by a corporation of its shares of capital stock, whether such proceeds are in excess of or less than the par value of the stock issued, constitute the capital of the company. If the stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount is not a loss deductible from gross income. If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the shareholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not

constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock. (See article 176.)

The foregoing article is contained in practically identical language in Reg. 45 (1918 Act), Reg. 62 (1921 Act), Reg. 65 (1924 Act), Reg. 69 (1926 Act), Reg. 74 (1928 Act), and Reg. 77 (1932 Act).

Treasury Decision 4430, approved May 2, 1934, XIII-1 Cumulative Bulletin 36:

ARTICLE 66: Sale by corporation  
of its capital stock.

XIII-20-6792  
T. D. 4430

(Also Section 23 (i), Article 176.)

INCOME TAX.

Acquisition or disposition by a corporation of its own capital stock.

Articles 543 and 563, Regulations 65 and 69, and articles 66 and 176, Regulations 74 and 77, amended.

TREASURY DEPARTMENT,  
OFFICE OF COMMISSIONER  
OF INTERNAL REVENUE,  
Washington, D. C.

*To Collectors of Internal Revenue and Others Concerned:*

Articles 543 of Regulations 65, approved October 6, 1924, and Regulations 69 approved August 28, 1926, and articles 66 of Regulations 74 approved February 15, 1929, and Regulations 77, approved February 10, 1933, are hereby amended to read as follows:

*Acquisition or disposition by a corporation of its own capital stock.*—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be

in excess of, or less than, the par or stated value of such stock.

But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of applicable statutes.

Articles 563 of Regulations 65, approved October 6, 1924, and Regulations 69, approved August 28, 1926, are hereby amended by striking out the first and second sentences thereof, by substituting the words "a corporation" in place of the second word in the third sentences of those articles, and by adding the following sentence to those articles:

As to the acquisition or disposition by a corporation of its own capital stock, see article 543.

Article 176 of Regulations 74, approved February 15, 1929, is hereby amended by omitting the first and second sentences thereof, by substituting the words "a corporation" in place of the second word in the third sentence of this article, and by adding the following sentence to this article:

"As to the acquisition or disposition by a corporation of its own capital stock, see article 66."

Article 176 of Regulations 77, approved February 10, 1933, is hereby amended by omitting the first and second sentences thereof, and by adding the following sentence to this article:

"As to the acquisition or disposition by a corporation of its own capital stock, see article 66."

GUY T. HELVERING,

*Commissioner of Internal Revenue.*

Approved May 2, 1934.

H. MORGENTHAU, JR.,

*Secretary of the Treasury.*

The logic supporting the principle that these transactions are capital transactions was clearly set forth in 1925 by Judge <sup>LEARNER</sup> ~~LEARNER~~ Hand in *Borg v. International Silver Co.*, 11 F. (2d) 147, at p. 150, as follows:

So we think that the resolution created no presumption that the defendant intended to retire the shares. But, if it did, the presumption would be rebutted by what took place at the time and thereafter. It is clear, from the way in which it treated the shares in 1908 and afterwards, that the defendant did not suppose the shares were retired, or were to be. If so, it would not have carried them as treasury stock for 15 years. We can construe the balance sheets in no other way. The shares should not have appeared in the sheets at all, or, if they did, only as held for retirement. To mark them as held "in treasury" was to ticket them as treasury shares; it could mean nothing else. The original note on the sheet for 1908 does not say anything to the contrary; they were not "outstanding," because they were held by the defendant; to be "outstanding," they must be effective obligations against it.

Against this it is argued that the shares should have been carried among the assets either at cost—as prescribed by the Interstate Commerce Commission—or at par, and that the assets should not have been reduced. The affidavits are not clear as to the most approved way of carrying treasury shares, and anyway we think the issue immaterial. Such shares are of necessity retired in this sense: That they constitute no longer any liability of the defendant. A corporation can have no right of action against itself, as must be if the share is truly a liability.

\* \* \* \* \*

To carry the shares as a liability, and as an asset at cost, is certainly a fiction, however admirable. They are not a liability, and on dissolution could not be so treated, because the obligor and obligee are one. They are not a present asset, because, as they stand, the defendant can not collect upon them. What in fact they are is an opportunity to acquire new assets for the corporate treasury by creating new obligations. In order to indicate this potentiality, it may be the best accounting to carry them as an asset at cost, providing,

of course, all other assets are so carried. Even so, a company which revalued its assets might properly carry them at their sale value when the revaluation was made. In any event there can be no ambiguity in stating the facts more directly, as the defendant did; that is, in treating the shares as not in existence while held in the treasury, except as a possible source of assets at some future time, when by sale at once they become liabilities and their proceeds assets. It makes no difference whether this satisfies ideal accounting or not.

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# Supreme Court of the United States.

OCTOBER TERM, 1938.

GUY T. HELVERING, COMMISSIONER OF INTERNAL  
REVENUE, *Petitioner*,

*v.*

R. J. REYNOLDS TOBACCO COMPANY.

*On Writ of Certiorari to the United States Circuit Court of  
Appeals for the Fourth Circuit.*

## BRIEF FOR THE RESPONDENT.

J. G. KÖRNER, JR.,  
404 Transportation Building,  
Washington, D. C.,  
*Attorney for Respondent.*

DAVID H. BLAIR,  
M. A. BRASWELL,  
404 Transportation Building,  
Washington, D. C.,  
*Of Counsel.*

December, 1938.

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# Supreme Court of the United States.

OCTOBER TERM, 1938.

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No. 328.

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GUY T. HELVERING, COMMISSIONER OF INTERNAL  
REVENUE, *Petitioner*,

*v.*

R. J. REYNOLDS TOBACCO COMPANY.

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*On Writ of Certiorari to the United States Circuit Court of  
Appeals for the Fourth Circuit.*

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**BRIEF FOR THE RESPONDENT.**

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OPINIONS BELOW.

The opinion of the Board of Tax Appeals (R. 20-28) is reported in 35 B. T. A. 949. The opinion of the Circuit Court of Appeals (R. 70-78), reversing the Board, is reported in 97 F. (2d) 302.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered June 6, 1938 (R. 78). The petition for certiorari was filed September 6, 1938 (R. 78), and granted October 17, 1938 (R. 78). The jurisdiction of this Court rests on section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

## QUESTION PRESENTED.

The question here presented is not the abstract question of whether this case is governed by the provisions of one regulation or another.

The question is whether a tenable statutory construction applied for approximately 25 years with the repeated affirmation of Regulations, Decisions and Rulings of the Department, by Board and Court decisions, and by repeated reenactments of the statute, has the force and effect of law; and whether the Court below correctly decided that, under those circumstances, and under the rule of this Court, such statutory construction should not be overthrown.

The Commissioner is asking that a construction placed upon a statutory definition (general in its terms)<sup>1</sup> by the Treasury Department and applied over a period of approximately 25 years, shall be held invalid, void, untenable, and unsupportable on any reasonable basis.

The Court below found and held that the said long continued construction has a reasonable basis to support it, and that it has the support of numerous Board decisions, court decisions, and text authorities. The Court below also found and held that a different construction would likewise be tenable. Under these circumstances the Court below applied the rule laid down by this Court to govern such cases, and sustained the long continued construction placed upon the statute by the Treasury Department. The Court below further held that since the departmental construction had for many years received the affirmation of the Board of Tax Appeals and of the Courts, and had received the sanction of Congress in five successive carefully considered revenue acts, such construction is controlling under the circumstances of this case.

The question therefore is whether the Court below was correct in following the rule of this Court applicable in such circumstances.

<sup>1</sup> Reference to Sec. 22 (a) of the Act, *infra* p. 67, shows that Congress in express words called it a "General definition."

## HOW THE ISSUE AROSE.

This was a petition to the Circuit Court of Appeals for the Fourth Circuit to review an order of the Board of Tax Appeals finding a deficiency in income tax for the year 1929, in the amount of \$37,865.62. The issue arose in this way:

The Commissioner determined a deficiency on a transaction totally unrelated to the transaction here in question, and mailed deficiency notice on April 3, 1933. He did not determine that the instant transaction was taxable and made no determination of deficiency relative thereto. Taxpayer filed petition in the Board of Tax Appeals on May 4, 1933. Answer was filed on June 27, 1933. Thereafter the cause was at issue for approximately three years, during which time the parties worked out an agreement and settlement of the only issue in the case. Then, on February 15, 1936, the Commissioner filed an amended answer in which he pleaded in effect that the Regulations in force in 1929, and under which taxpayer had made the instant transaction, were invalid and that the taxpayer had realized taxable income from said instant transactions in 1929. Taxpayer filed reply to said amended answer on March 14, 1936, and pleaded that the transactions in question had been made under and pursuant to the provisions of the Revenue Act of 1928, and the Regulations duly promulgated thereunder, and that the construction placed upon the statute by Departmental Regulations, Decisions and Rulings, and by Board and Court decisions, had continued for many years, and that during that period the revenue act had been repeatedly reenacted without change. Taxpayer pleaded the rule of this Court applicable under such circumstances as a complete bar to recovery of an additional deficiency arising by reason of the instant transactions. The petitioner further pleaded that the said construction was a sound construction and that the transactions in question were not taxable.

The Board found for the Commissioner. The taxpayer sought review in the Circuit Court of Appeals for the Fourth Circuit. That Court reversed the Board and held that the case is governed by the doctrine and rule of this Court that if a

statute is reasonably susceptible of two constructions, its reenactment, after a construction by responsible officials has been long maintained, amounts to a legislative sanction of that construction.

### STATEMENT.

The facts, as found by the Board of Tax Appeals, appear at R. 14-20. The facts as found by the Court below appear at R. 70-74. The facts are not in dispute.<sup>1</sup> They may be summarized as follows:

Taxpayer corporation had issued its stock for cash. Thereafter it reacquired certain shares of its own stock for cash. Such acquisition was not pursuant to any contract agreement. Such stock was later reissued for cash, to persons desiring to acquire stock of the company. The original certificates were cancelled and new certificates issued.

The acquisition and reissue of such stock was effected for the purpose of protecting and preserving (1) the reputation of the company, (2) the reputation of the company's products and brands, and (3) the reputation of the company's stock. Each such transaction was made by the company under conditions which necessitated such action and under the necessity of protecting the company's business from a threatened peril (R. 16, bot. 17, near bot. 52, mid. 53, bot. 53, mid. 54, bot. 54, top 55, bot. 55, mid. 56). The company acquired none of this stock as a medium of payment in any transaction in which the company sold an asset or a commodity (R. bot. 60). The company's charter did not authorize it to deal in stocks of any kind. The company did not believe that these transactions constituted dealing in stock (R. bot. 57, top 58). The company has never dealt in corporate shares (R. mid. 60). The sole purpose in the instant transactions was to protect the company and its business in a special situation (R. top 57, bot. 57, mid.

<sup>1</sup> Taxpayer would, however, call attention to a minor error occurring in the 3d paragraph of R. 18, where the date mentioned should read "September 18, 1929," instead of "December 18, 1929." See record near bot. p. 54.

59, mid. 56). The reissuance of the stock here involved occurred in 1929. Some of the stock so reissued in 1929 had been acquired by the company in 1921 and had been held by the company as treasury stock since that time. The remaining shares so reissued had been acquired earlier in the year 1929 (R. 14, bot. 18, top 19, near bot. 72).

All said reacquisitions and reissues of its stock were made solely for cash and in no instance for anything except cash (R. near bot. 19, 14, 44, 45, 58) and at the open market price (R. 14, 51, 59) as quoted on the exchange (R. mid. 51). None of such transactions were margin transactions (Stip. #9, R. 44). The company was not speculating or trafficking in its stock for a profit, as it was within its power to acquire the stock at much lower prices (R. near bot. 56). The company wanted to get its stock generally into the hands of its employees and was willing to let them have it at cost (R. top 57). The company never conceived that its transaction was a dealing or trafficking in stock (R. top 58).

The company made said transactions in view of departmental regulations, rulings and decisions, then in force and effect, and in the belief that the departmental regulations were correct and controlling (R. top 20, near top 52, mid. 73). Its tax return conformed to the Regulations (R. top 21).

Under the Revenue Act of 1918, the Department promulgated Regulations 45, Art. 542, holding that where a corporation acquires stock previously issued by it, the sale of such stock constitutes a capital transaction and the proceeds of such sale constitutes capital and not income of the corporation, and that a corporation realizes no gain or loss from the purchase or sale of its own stock. That construction was applied by Departmental Rulings to prior Revenue Acts (the Revenue Acts of 1913 and 1916) and to the Corporation Tax Act of 1909.

That Regulation was continued without change down to 1934. During that period the Department issued many rulings and decisions supporting and reaffirming that regulation. The Commissioner repeatedly defended that regulation before the Board of Tax Appeals. The Board repeatedly

affirmed it by published decisions. The Regulation received the approval of the Circuit Courts of Appeals.

In 1929 these regulations, rulings and decisions were in force and effect and were at that time being continuously applied and vigorously defended by the Department,<sup>1</sup> and in 1929 the taxpayer made its transactions. A more detailed chronology of the history of the long continued construction will be set forth hereinafter.

In 1934, the Department issued *Treasury Decision 4430*, C. B. XIII-1, 36. That was after the established rule had been applied for about 25 years, by rulings and decisions of the Department and about 16 years after it had remained continuously in the Regulations, and about 5 years after the taxpayer had made its instant transactions. The effect of *Treasury Decision 4430* was to declare invalid and of no effect all the Regulations, Rulings and Decisions above referred to. The Commissioner invoked this new ruling in the instant case some 3 years after the instant cause was at issue in the Board.

In the instant case the position of the Commissioner is that: (1) the long continued regulations, rulings and decisions of the Bureau, the Board, and the Courts, are null and void and of no effect, (2) that they are and have always been plainly and obviously wrong and untenable and without any reason to support them, (3) that the repeated reenactments of the statute, without change, give no support to them, and (4) that they were invalid and void in 1929 and in all the years during which they were in effect and while they were being enforced by the Department.

## STATUTES AND REGULATIONS INVOLVED.

These are printed in Appendix A, *infra*, pp. 67-69.

<sup>1</sup> In his brief filed in the Board in 1926, in *Emerson Electric Co.*, 3 B. T. A. 932, the Commissioner cited and quoted Art. 542 of Reg. 45 and argued (as he had done in all the previous cases) that the Regulation was not contrary to the intent and purpose of the Revenue Act's definition of income, but that it was fully in accord therewith; and then said: "*This regulation has been applied and followed for so long as to become stare decisis under the principle announced by the Supreme Court in the Flannery case.*"

## SYNOPSIS OF RESPONDENT'S CONTENTIONS.

*First:* The Court below properly found that the Regulations and Decisions of long standing were reasonable.

*Second:* The Court below properly decided that since there was reason to support the interpretation contained in the long continued Regulation and Decisions, and since the statute has been repeatedly reenacted without change in light of such long continued construction, the Regulation has received the approval of the Congress, has the force and effect of law, and its overthrow is not now plainly required and it may not now be overthrown as clearly and plainly wrong.

*Third:* The application of a new and different regulation retroactively (over that portion of the years to 1924) is not a sporadic discrimination but is deliberate and capricious and leads to unjust, oppressive and inconsistent results, and violates the rule of uniformity in taxation.

*Fourth:* The cases relied upon below by the Commissioner for his *volte face* in interpreting the statute do not support him since they relate to transactions totally different from the instant transaction.

## ARGUMENT.

It is submitted that the Court below correctly applied the rule, under the well established doctrine of this Court, that when a statute is reasonably susceptible of two constructions, its repeated reenactment in light of an interpretative ruling by responsible officials, amounts to a legislative sanction of the course pursued, and especially when the construction has been long maintained and several reenactments of the statutory language have taken place (R. Mid. 77). The decision of the Court below was just and proper.

*The Decision of the Court Below Does Not Sustain a Contention which Exempts Income from Taxation.*

The decision below does not purport to uphold an exemption from taxation, as has been suggested by the Commissioner.

The decision is specifically grounded on the proposition that there is reason and authority to support the long continued construction put upon the statute, and that accordingly the duty of the Court was clear in applying literally the mandate of this Court applicable under the circumstances.

The long continued rule of construction was that in transactions of this kind no income could or did accrue to the corporation,<sup>1</sup> and that the sale by a corporation of its own reacquired stock constitutes a capital transaction and the proceeds of such sale do not constitute income because a corporation realizes no gain or loss on the purchase or sale of its own stock.<sup>2</sup> It is thus apparent that the long continued construction is not one which exempts a taxpayer's gain from taxation. *Eisner v. Macomber*, 252 U. S. 189, 207.

*The Decision of the Court Below is Correct.*

It should first be clearly understood exactly what the Court below decided. It decided only that, as between two reasonable constructions of the statute, that construction which has received long and continuous application by responsible officials, and in light of which several reenactments of the statute have taken place, must be held to have received legislative sanction.

Three main elements appear in the decision: (1) the duration of the construction, (2) the presence of reason to support it, and (3) the repeated reenactments of the statute, without change, during the continuance of that construction.

The history and long duration of the construction will be set forth in chronological form showing its long continued application. That there is authority and reason to support it is shown by the numerous decisions rendered in support of it, over a long period of years, by many responsible departmental officials, by the Board of Tax Appeals, and by the Courts. The

<sup>1</sup>Law Opinion 296, 5 C. B. top 210, issued under the 1913 Act; A. R. R. 693, 5 C. B. 207, bot. 209.

<sup>2</sup>Reg. 45, Art. 542; Reg. 62, Art. 543; Reg. 65, Art. 543; Reg. 69, Art. 543; Reg. 74, Art. 66; Reg. 77, Art. 66.

reenactments of the revenue act speak for themselves. The history of the construction, the support it has had in many considered opinions and decisions, and the reenactments of the statute will be here briefly, but by no means exhaustively, reviewed.

Very early in the history of income taxation the construction of the statutory *general definition* of income, as applied to transactions of the kind here involved, came under consideration by the departmental officials charged with the duty of administering the statute and promulgating regulations pursuant thereto. The then outstanding authorities on the subject were in general agreement that reacquired, or treasury, stock was not property, or a commodity, in the hands of the issuing corporation; that the issue of such stock has the same effect as the original issue of such stock; and that the issuance of such stock was a capital issue and constituted a capital transaction resulting in neither gain nor loss. Among such authorities were the many text writers on the subject whose views were to the same effect and have, without substantial variance, prevailed from that day down to the present.

Among such authorities are the following:

Esquerre, "*Applied Theory of Accounts.*" (See 2 C. B. 211.)

Dickinson, "*Accounting Practice & Procedure,*" 130, 132.

Paton, "*Accountants' Hand Book,*" 931-2, 980-1.

Paton, "*Accounting Theory,*" (1922), pp. 380-385.

Paton, "*Accounting Terminology,*" p. 119.

Wildman and Powell, "*Capital Stock Without Par Value,*" 93-4.

Sunley and Pinkerton, "*Corporation Accounting,*" 121.

Kester, "*Accounting Theory and Practice,*" 17.

Glenn, "*Treasury Stock,*" 15 Va. L. R. 625, 637.

Esquerre, "*Practical Accounting Problems,*" Part II, 1922, 6-81.

Hills, "*Stated Capital and Treasury Shares,*" *Journal of Accountancy*, Vol. 57, Jan. to June, 1934, 202, 212, 213.

- Marple, "*Treasury Stock*," *Journal of Accountancy*, Vol. 57, Jan. to June, 1934, 257, 262-3.
- Holmes, "*Federal Taxes*," (6th Ed.) p. 236.
- Morowetz on *Private Corporations* (2d Ed.), Vol. 1, sec. 112, p. 109.
- Montgomery, "*Income Tax Procedure*," Vol. 1, 1926 Ed. p. 690; Vol. 1, 1927 Ed. p. 331; 1938 Ed., p. 27.<sup>1</sup>
- Streightoff, "*Advanced Accounting*," 134-5.
- Hatfield, "*Accounting*," 183.
- Sanders, Hatfield and Moore, "*Statement of Accounting Principles*," 90.
- Payne, "*Treasury or Reacquired Stock*," *The Certified Public Accountant* (Feb. 1936), Vol. 16, 98.
- Holt and Morris, "*Some Aspects of Reacquired Stock*," *Harvard Business Review*, XII, 507-8.
- Federal Trade Commission, "Release #131," March 13, 1934.
- Federal Reserve Board Bulletin, "Verification of Financial Statements" (1929 Revision).
- May, "*Recent Opinions on Dealings in Treasury Stock*," *Journal of Accountancy*, Vol. 66, 17 (July, 1938).
- Report of Committee on Accounting Procedure, American Institute Accountants (May, 1938), *Journal of Accountancy*, Vol. 65, 417-418, which is reprinted in full in Appendix C, *infra*, p. 74.

The rule is variously stated by the authorities: *Dickinson, supra*, says:<sup>2</sup>

An important question arises as to the treatment of stock of a corporation held in its own treasury. \* \* \*

\* \* \* The capital stock represents the manner in which its property and assets are distributed among those who constitute the corporation. If one of these owners disposes of his share to the corporation, he withdraws therefrom,

<sup>1</sup> In his 1938 Edition, Montgomery reviews the decision of the Court below in the instant case and says: "The decision is sound."

<sup>2</sup> As quoted in A. R. R. 799, C. B. 1-1, 374 (1922).

taking with him what he considers his fair proportion of the asset value, and leaving the rest to be divided among the remaining owners. \* \* \* [For example]: A corporation has a capital stock of \$1,000,000, divided into 10,000 shares of \$100 each, and represented by assets of equal value. The holders of 1,000 shares withdraw, i. e., sell their shares to the company at the book value which in this case is par. The stock is thereby reduced to 9,000 shares, i. e., \$900,000, and the assets are similarly reduced by the payment of \$100,000 to \$900,000. There is clearly no reason whatsoever for pretending that there are still 10,000 shareholders and assets of \$1,000,000 when as a matter of fact there are only 9,000 with assets of \$900,000, and the position of those 9,000 is entirely unchanged.

*Paton's Accountants' Handbook*,<sup>1</sup> *supra*:

It has already been stated that the term "treasury stock" applies properly only to reacquired stock—that is, issued stock no longer outstanding in the hands of the public because of purchase by or donation to the corporation. (p. 934.)

When treasury stock is resold, any gain resulting from the excess of the selling price over par or average stated value should be regarded as a contribution of a stockholder and credited to paid-in surplus. \* \* \* (p. 935.)

Surplus arising from a company's dealings in its own stock is clearly analogous to paid-in surplus, \* \* \*. The transaction clearly results in a realignment of legal rights, \* \* \*. (p. 980.)

*Paton's Accounting Terminology*, *supra*, says that surplus consists of capital surplus and earned surplus; that capital surplus includes paid-in surplus, and that paid-in surplus includes the gains on resales of treasury stock.

*Wildman & Powell*, *supra*, pp. 93-94:

Next may be considered the question of acquiring treasury stock at one price and disposing of it at a higher

<sup>1</sup> W. A. Paton, Phd. D., C.P.A., Professor of Accounting at University of Michigan.

price. Two transactions of this character undoubtedly give rise to what generally is termed a profit. \* \* \* However, treasury stock probably may not be regarded as in the same category with merchandise. \* \* \* Consequently it seems not unreasonable to argue that the two transactions just mentioned are merely two adjustments of the capital account.

*Hathfield's Accounting, supra, 183:*

For income tax purposes, however, the proceeds of the sale of treasury stock do not constitute income of the corporation.

*Sunley and Pinkerton, supra, 121:*

When a *commodity* is sold by a corporation it passes out of its possession, and ordinarily the deal is closed; *but when shares* are sold the deal really continues on, for the buyers of these shares are taken into participation in the corporation's financial affairs. \* \* \*

No corporation is organized for the declared purpose of making profits on transactions in its own stock. *Such profits are hardly "earnings" and should be classified as paid-in surplus.* (Italics supplied.)

*Kester, supra*, says that when treasury stock is resold, any gain on the sale should be carried to surplus account as a contribution to capital.

*Hills, supra*, discusses the subject at length and says that it is obviously unwise to subject earnings to increase or decrease coincident with the acquisition and sale of treasury shares. He concludes: "*The transactions of a corporation in its own shares should be considered as capital transactions.*"

*Marple, supra*, says:

When treasury stock is sold, the sales price would be recorded as a debit to cash (or other asset) and a credit to "Surplus applied in acquisition of treasury stock" \* \* \*.

If \* \* \* the stock were sold for more than cost \* \* \* the \* \* \* excess over cost would represent additional contributed capital and be credited to capital surplus.

Glenn, *supra*, concisely summarizes the rule thus:

In truth, then, treasury stock is not stock at all \* \* \*. Forever do we have to return to this hard realism—when a corporation gives anything for its own stock the corporation is out an asset. Against that it has left only the possibility that some day, under some circumstances, it may succeed in again getting value back into the treasury to replace the value it has lost, by the process of again selling this treasury stock, which meanwhile, in actual truth, represents a void.

In practical business affairs the rule is likewise applied. The following quotation is from a New York Stock Exchange Bulletin issued to all listed companies under date of December 18, 1933:

The repurchase by a corporation of its outstanding stock amounts, in effect, to a reduction in capital.

A corporation which carries its own reacquired stock as an asset may sell these holdings at any time without notice. *Such sales, in effect, represent an increase in capital without the detailed information which would be required if the corporation were issuing additional stock. (Italics supplied.)*

The *Federal Trade Commission* in its "*Registration Statement*" required by the Securities Division of that Commission, for filing under the Federal Securities Act of 1933, directs that applicants for registration of security issues must deduct treasury stock from total capital stock, to include the excess of the proceeds from the sale of capital stock over the par or stated value thereof as paid-in surplus, and to include discount on capital stock as capital surplus.

Likewise, the *Federal Trade Commission* in its Release #131 of March 13, 1934, in administering the Securities Act of 1933, held that treasury stock originally issued before the effective date of that Act must be registered under that Act before it may be sold. By this ruling that Commission holds that treasury stock is in no wise different from unissued stock, when

it is disposed of by the issuing corporation. The Commission's ruling is obviously predicated upon the sound principle that when a corporation acquires its own stock for cash it is merely paying off one stockholder and when it *disposes of the same stock it is securing another stockholder who is adding capital to the corporation*. The fact that one stockholder may be willing to relinquish his holdings for a price less than some other stockholder may be willing to pay for that interest in the corporation, does not in any way add to the income of the corporation, but merely adds to its capital.

The *Federal Reserve Board*, Washington, D. C., in the 1929 revision of its Bulletin entitled "Verification of Financial Statements" submits a recommended form of balance sheet in which treasury stock is deducted from issued stock in the corporation's capital stock accounts.

The rule is epitomized in the oft quoted statement of Judge L. Hand in *Borg v. International Silver Co.*, 11 F. (2d) 147, 150 (1925), relative to treasury shares:

\* \* \* It is clear, from the way in which it treated the shares in 1908 and afterwards, that the defendant did not suppose the shares were retired, or were to be. If so, it would not have carried them as treasury stock for 15 years. \* \* \*

\* \* \* Such shares are of necessity retired in this sense: That they constitute no longer any liability of the defendant. A corporation can have no right of action against itself, as must be if the share is truly a liability. \* \* \*

To carry the shares as a liability, and as an asset at cost, is certainly a fiction, however admirable. They are not a liability, and on dissolution could not be so treated, because the obligor and obligee are one. They are not a present asset, because, as they stand, the defendant can not collect upon them. What in fact they are is an opportunity to acquire new assets for the corporate treasury by creating new obligations. In order to indicate this potentiality, it may be the best accounting to carry them as an asset at cost, providing, of course, all other assets are so carried. Even so, a company which revalued its assets might properly carry them at their sale value when the revaluation was made. In any event there can

be no ambiguity in stating the facts more directly, as the defendant did; that is, in treating the shares as not in existence while held in the treasury, except as a possible source of assets at some future time, when by sale at once they become liabilities and their proceeds assets. It makes no difference whether this satisfies ideal accounting or not.

The Treasury Department gave careful consideration to this question in light of existing authorities, and ruled that if a corporation reacquires shares of its own stock previously issued by it, and later sells and reissues such stock, such sale constitutes a capital transaction and the proceeds of the sale constitute capital and not income to the corporation. This construction was later adopted as a departmental *Regulation* with the approval of the Secretary (Regulations 45, Art. 542, promulgated under the Revenue Act of 1918). Soon thereafter, the Department promulgated *Law Opinion 1035*, 2 C. B. 132, approving the rule and stating that it applied with equal force to the Revenue Act of 1916 and to the Corporation Tax Act of 1909. Soon after that the Department promulgated ruling *A. R. R. 693*, 5 C. B. 207, 209, stating that the provisions of the Regulation applied to revenue acts prior to the Revenue Act of 1918.

From that time forward, and down to 1934, the above principles were affirmed and reaffirmed year after year, by repeated Departmental Rulings and by continuous inclusions in the Departmental Regulations promulgated under each succeeding Revenue Act—each Revenue Act being reenacted in light of such continued construction, and in each instance without change. The chronology of these Departmental Rulings and Regulations is as follows:

*Law Opinion 296*, 5 C. B. top p. 210.<sup>1</sup>

*Law Opinion 426*, 5 C. B. mid. p. 210.<sup>2</sup>

<sup>1</sup> The date of L. O. 296 is not given but it is stated that it was issued under the Revenue Act of 1913.

<sup>2</sup> The date of L. O. 426 is not given but it is stated that it was issued under the Revenue Act of 1916.

- 1919 *Revenue Act of 1918.*
- 1920 *Treasury Regulations 45, Art. 542 and 563, pursuant to 1918 Act.*
- 1920 *Law Opinion 1035, 2 C. B. 132.*
- 1920 *Law Opinion 1035 (Revised), 3 C. B. 160, 162.*
- 1921 *Treasury Decision 3206, 23 T. D. 763.*
- 1921 *A. R. R. 693, 5 C. B. 207.*
- 1921 *Revenue Act of 1921.*
- 1922 *Treasury Decision 3295, 24 T. D. 207, promulgating Treasury Regulations 62, Art. 543 and 563, pursuant to 1921 Act.*
- 1922 *I. T. 1198, C. B. I-1, 275.*
- 1922 *A. R. R. 799, C. B. I-1, 374.*
- 1923 *I. T. 1736, C. B. II-2, 274.*
- 1923 *I. T. 1802, C. B. II-2, 267.*
- 1924 *Revenue Act of 1924.*
- 1924 *Treasury Decision 3640, 26 T. D. 745, promulgating Treasury Regulations 65, Art. 543 and 563, pursuant to 1924 Act.*
- 1924 *S. M. 2205, C. B. III-2, 244.*
- 1924 *A. R. R. 8159, C. B. III-2, 256.*
- 1926 *Revenue Act of 1926.*
- 1926 *Treasury Regulations 69, Art. 543 and 563, pursuant to 1926 Act.*
- 1928 *Revenue Act of 1928.*
- 1928 *Treasury Regulations 74, Arts. 66 and 176, pursuant to 1928 Act.*
- 1932 *Revenue Act of 1932.*
- 1932 *Treasury Regulations 77, Art. 66 and 176, pursuant to 1932 Act.*
- 1934 *Revenue Act of 1934.*<sup>1</sup>

<sup>1</sup> When the Revenue Bill of 1934 was under consideration by Congress the Sub-Committee of the Ways & Means Committee officially reported on Dec. 4, 1933, as follows:

The Sub-committee have given attention to these matters nearly continuously except for the months of August and September. In connection with their investigations they have had full cooperation from representatives of the Treasury Department, of the legislative counsel's office of the House, and of the staff of the Joint Committee on Internal Revenue Taxation.

Let us examine briefly some of those decisions of the Treasury Department. They are all to the same effect.

The Regulations (Nos. 45, 1918 Act; 62, 1921 Act; 65, 1924 Act; 69, 1926 Act; 74, 1928 Act; 77, 1932 Act) speak for themselves. They all are alike and all state the rule as set out in Art. 66, Reg. 74, in Appendix A.

The decisions of the Treasury Department set forth the reason and philosophy supporting those Regulations. They were issued by the officials charged with the obligation of interpreting and administering the Acts.

*Law Opinion 296*, *supra*, issued by the Solicitor of Internal Revenue under the 1913 Act, said:

The stock of a corporation held by any person *other than the corporation which issued it* of course constitutes an asset and one receiving in exchange capital stock of ascertained market value greater than the cost to him of the asset given in exchange might realize a taxable profit from the transaction, but when stock is acquired by the corporation which issued it, in exchange for assets of the corporation, the transaction has an entirely different character. *The stock is then necessarily diminished in value by the amount of the assets which the corporation has exchanged for it \* \* \** The whole exchange from the standpoint of the O Company was a capital transaction: capital stock, a bookkeeping capital liability, was acquired and extinguished by a *surrender of assets including capital assets, the beneficial interest in which was previously represented by the stock acquired. No income could or did accrue to the O Company from this transaction. Its capital account alone was affected.* \* \* \* (Italics supplied.)

Under the *Revenue Act of 1916*, the principle was supported in *Law Opinion 426 supra*.

*Law Opinion 1035*, 2 C. B. 132, was promulgated in the spring of 1920 under the 1918 Act. It held that where a corporation purchased shares of its own stock and later resold it at a profit, no part of the proceeds of such sale should be included in gross income.

*Law Opinion, 1035 (Revised)*, *supra*, in the autumn of 1920, reaffirmed the principle.

Thus it is seen that the application of this principle goes back to the very beginning of the income tax.

A. R. R. 693,<sup>1</sup> *supra*, was rendered in the autumn of 1921. It cited and quoted with approval the previous *Law Opinions, supra*, and *Esquerre, supra*. It approved the definition of "treasury stock" set out in existing Regulations:

*Treasury stock wherever and whenever the term is used in connection with the accounts of the corporation or for income tax purposes, will be held to mean stock which had been previously issued by the corporation and which had been repossessed by it through purchase or otherwise, and then carried on its books as an asset. (Italics supplied.)*

The decision reviewed the entire subject matter and concluded:

In view of the foregoing matters, the Committee concludes that the transaction in the instant case was a capital one and not one in which there resulted a loss from the sale, exchange or other disposition of property such as may properly be deducted in the computation of taxable net income \* \* \*.

A. R. R. 799, *supra*, appeared in 1922. Therein the taxpayer contended that treasury stock (reacquired stock) was an asset in its hands. The decision discussed the subject exhaustively, quoted extensively from *Dickinson, supra*, cited many Court cases, and dismissed the taxpayer's contention and held that treasury stock could not constitute an asset in the hands of the issuing corporation. The decision said:

*It will be seen that the above definition can not include a corporation's own stock which it has purchased from its stockholders in the open market for the simple reason that whatever the corporation pays to the stockholder for his share of stock is a withdrawal by such stockholder of the amount of capital originally contributed to the capital stock of the*

<sup>1</sup> "A. R. R." is the citation of a decision of the "Committee on Appeals and Review" which was a Departmental Appellate Body. It was in effect the forerunner of the *Board of Tax Appeals* which in effect supplanted it in 1924.

*company. By such withdrawal the share which his interest represented is extinguished because it has been so withdrawn. The amount of capital originally contributed still in the hands of the corporation constitutes the remaining capital stock, of which it can not be said that the interest formerly represented by the share of the withdrawing stockholder is a part. (Italics supplied.)*

The many other Departmental Decisions listed *supra*, are to the same effect.

It was in light of the Departmental Decisions that the Regulations were issued and reissued; and it was in light of those Decisions and Regulations that the Statute was repeatedly reenacted without change. As will be shown later, after 1924 the statutes were so reenacted in light of additional decisions to the same effect rendered by the Board of Tax Appeals and by the Courts.

From the foregoing it is seen that the rule was applied by the Treasury Department through Rulings, Decisions and Regulations from 1909 down to and including the time of the passage of the Revenue Act of 1934—a period of approximately 25 years. During that long period of years the rule was made the subject of consideration, ruling, decision and affirmation by not less than seven Solicitors and General Counsels, six Commissioners of Internal Revenue, and five Secretaries of the Treasury.

In the meantime, however, the Board of Tax Appeals had come into existence in 1924. The Commissioner repeatedly argued before the Board in support of the Departmental construction,<sup>1</sup> and the Board repeatedly affirmed it. The Board held in *Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803 (1925) that where a corporation sold shares of its own stock which it had previously reacquired, no loss occurred to the corporation. That decision was followed by the Board and applied under varying states of fact:

1925 *Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803.

1925 *Cooperative Furniture Co.*, 2 B. T. A. 165.

- 1925 *Atlantic Carton Co.*, 2 B. T. A. 380.
- 1926 *Emerson Electric Co.*, 3 B. T. A. 932.<sup>1</sup>
- 1926 *Illinois Rural Credit Ass'n*, 3 B. T. A. 1178.
- 1926 *Hutchins Lumber & Storage Co.*, 4 B. T. A. 705.
- 1926 *Farmers Deposit National Bank*, 5 B. T. A. 520.
- 1926 *H. S. Crocker Co.*, 5 B. T. A. 537, 541.
- 1926. *Interurban Construction Co.*, 5 B. T. A. 529.
- 1926 *Liberty Agency Co.*, 5 B. T. A. 778.
- 1927 *Simmons Company*, 8 B. T. A. 631, 645; aff'd 33 F. (2d) 75 (CCA 1); cert. denied 280 U. S. 588.
- 1928 *Union Trust Co.*, 12 B. T. A. 688, 690.
- 1929 *105 West 55th Street, Inc.*, 15 B. T. A. 210, 213; aff'd 42 F. (2d) 849 (CCA 2).
- 1929 *Riggs National Bank*, 17 B. T. A. 615, 618; aff'd 57 F. (2d) 980 (CCA 4).
- 1930 *J. H. Johnson*, 19 B. T. A. 840, 847; aff'd 56 F. (2d) 58 (CCA 5); cert. denied 286 U. S. 551.
- 1930 *American Cigar Co.*, 21 B. T. A. 464, 495; aff'd 66 F. (2d) 425 (CCA 2); cert. denied 290 U. S. 699.
- 1930 *Inland Finance Co.*, 23 B. T. A. 199; aff'd 63 F. (2d) 886 (CCA 9).
- 1932 *Carter Hotel Co.*, 25 B. T. A. 933; aff'd 67 F. (2d) 642 (CCA 4).

In each of the above cases it was the Treasury Department which contended for the rule for which the instant taxpayer now contends. During that period of several years the Commissioner in those cases held that no gain or loss occurred when a corporation reacquired its own stock for cash and later reissued it for cash. The Board and the Courts consistently sustained the Commissioner.

The rule insisted upon by the Commissioner, and sustained by those decided cases, is shown by reference to a few of such cases.

In *Simmons & Hammond Mfg. Co.* (1925), *supra*, the

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<sup>1</sup> See footnote, bot. p. 6, *supra*.

corporation reacquired shares of its own stock for cash and later reissued them for cash. The taxpayer contended this treasury stock constituted an asset in its hands and its sale gave rise to gain or loss. *The Commissioner contended that it was not an asset and that no gain or loss resulted. The Board said:*

It was urged upon us that shares of its issued and outstanding stock repurchased by a corporation, representing treasury stock, are in as full a sense an asset as would be Liberty Bonds or commercial securities. An analysis of this position discloses its fallacy. Such bonds and securities have an asset value totally divorced from any liability thereon of the corporation holding them. The capital liability of such a corporation remains undisturbed by the purchase of such securities. It is readily apparent that such is not the case where a corporation purchases shares of its own stock. Irrespective of how the corporation may choose to treat such stock, there is nevertheless a very real shifting and adjustment of assets and liabilities which takes place perforce. There may be such a treatment of the transaction by the corporation as to show a bookkeeping loss or gain (as was the case here), but it is not actual and real. For that reason we hold that there was in the instant appeal no actual or realized loss. We are of opinion that the method used in this transaction by the corporation was in truth and fact a distribution of surplus to Simmons and Hammond. Much could be said in support of this view upon an analysis of the manner in which the sale was made to Simmons and Hammond, but we are satisfied that our conclusion is correct on principle and does not require the support of such analysis. The determination of the Commissioner in this respect is approved.

In *Hutchins Lumber & Storage Co.* (1926), *supra*, the Board said:

The important facts upon which we must adjudge the character of this transaction are—that the Booth-Kelley Lumber Co. had acquired this stock from the petitioner for the sum of \$30,000, which became a part of the petitioner's paid-in surplus; that upon the repurchase of this stock the petitioner returned to the Booth-Kelley

Lumber Co. the latter's contribution of \$30,000 capital and its share in the petitioner's accumulated surplus. *It was a capital transaction involving a return to this particular stockholder of its capital contribution plus its share in the accumulated surplus, and the paid-in capital and surplus, of which these funds were a part, were lessened by the withdrawal of the same. The purchase by a corporation of its own capital stock eliminates the stockholder without substituting another in his place, repays to the withdrawing member his share of the capital, and reduces the amount of the fund contributed to the common venture. See Appeal of Simmons & Hammond Mfg. Co., 1 B. T. A. 803. (Italics supplied.)*

In *Farmers Deposit National Bank*, 5 B. T. A. 520 (1926), the Board said:

That a corporate taxpayer realizes no taxable gain from the sale of its own capital stock is a well established principle of the taxing statutes. It is a principle which the Commissioner has consistently adhered to in all of the regulations promulgated under the several Revenue Acts. In the *Appeal of Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803, this Board held that the sale by a corporate taxpayer of its own capital stock constituted a capital transaction and that no deductible loss resulted therefrom. It follows, *per contra*, that a corporate taxpayer realizes no taxable gain from the sale of its own capital stock. (Italics supplied.)

In *H. S. Crocker Co.* (1926), *supra*, the Board said: "We have heretofore held that dealings by a corporation in its own capital stock give rise to no profit or loss. *Appeal of Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803."

In *Liberty Agency Co.* (1926), *supra*, the Board said:

We are of opinion that the petitioner realized no taxable gain when it purchased its own preferred stock at a cost to it of \$5,025 less than its stockholders had theretofore paid for it. *This was wholly a capital transaction. Appeal of Simmons & Hammond Mfg. Co., 1 B. T. A. 803. \* \* \** (Italics supplied.)

In *Simmons Company* (1927), *supra*, affirmed 33 F. (2d) 75 (1929), certiorari denied 280 U. S. 588, 74 L. ed. 637, the Board said:

We think this is properly conceded in view of the previous decisions of this Board that *a corporation can have no gain or loss on the sale or purchase of its own stock. See Appeal of Simmons & Hammond Mfg. Co., 1 B. T. A. 803. \* \* \* (Italics supplied.)*

In *Union Trust Co.* (1928), *supra*, the Board said:

We see no basis on which the petitioner can escape the conclusion that this stock was owned by it and that the sale was no more nor less than a sale by it of its own capital stock. The Board has previously held that no taxable gain or loss results when a corporation buys or sells its own capital stock. *Simmons & Hammond Mfg. Co., 1 B. T. A. 803; Farmers Deposit Nat'l Bank, 5 B. T. A. 520; Simmons Co., 8 B. T. A. 631.*

*105 West 55th St., Inc.* (1929), *supra*, affirmed 42 F. (2d) 849 (1930), the Board sustained the Commissioner, saying (p. 213):

Had Hearn been permitted to purchase the stock he claimed he was entitled to buy, the purchase would have been a capital transaction resulting in neither gain nor loss to the corporation, irrespective of the price paid therefor. *Simmons & Hammond Mfg. Co., 1 B. T. A. 803 \* \* \*.*

*As was pointed out in the Simmons case, the only result so far as the corporation is concerned is a change in the capital structure. (Italics supplied.)*

The Second Circuit, in affirming the Board, said (p. 851) that

*\* \* \* there was nothing more than a distribution of assets to a minority stockholder to preserve the existing stockholding ratio of two to one between the two sole owners of the corporation. It was merely a matter affecting the capital structure of a corporation \* \* \*. (Italics supplied.)*

In *Riggs National Bank* (1929), affirmed 57 F. (2d) 980 (1932), the Board said: "The Board had also decided that a corporation derived no taxable gain and sustained no deductible loss by reason of dealings in its own stock."

In *J. H. Johnson* (1930), *supra*, affirmed 56 F. (2d) 58, the Board said:

The amount paid to Davis by the Barr-Davis Oil Co. for his stock was clearly no part of the cost of the oil and gas lease the company had theretofore acquired. Nor was it a loss to the company. It was a capital transaction that amounted to a distribution to Davis of part of the company's assets which did not result in gain or loss to the company. *Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803.

The Fifth Circuit Court of Appeals in affirming the Board, 56 F. (2d) 58, said:

Argument is unnecessary to demonstrate that what was paid to Davis for his stock added nothing to the actual cost of the assets. The Treasury Department has always ruled that a corporation receives no gain or loss from the purchase of its own stock. See article 543, T. R. 62 (1921). *This is a reasonable and logical ruling and may be considered to have congressional approval by the enactment of subsequent revenue laws without any attempt to change it. The Board of Tax Appeals has consistently followed this ruling, holding such purchases to be capital transactions, amounting to a distribution of the stockholders' share of the assets. (Italics supplied.)*

Certiorari was denied 286 U. S. 551 (1932).

As pointed out above (p. 14), it was in 1925 that *Borg v. International Silver Co.* was decided. That case sets forth fully the reason underlying the Treasury Regulations and Decisions, and the decisions of the Board.

Later the same Court had under consideration *Founders General Corp'n v. Com'r*, 79 F. (2d) 6, 8, wherein a subsidiary sold stock of the parent. In an opinion, concurring in part and dissenting in part, Judge L. Hand again succinctly states the underlying principle:

*When a company issues shares, it makes the holder a member of the group of shareholders; when it buys them, this member retires from the group and takes his share of the assets. Assuming that he gets no more than his shares are worth at that moment, the group, i. e., the corporation, has neither lost nor gained. That is the naive view and the right view, freed from fictions; and it is the view of the regulations. Article 66, Regulations 74. (Italics supplied.)*

The above reference is to the very Article of the Regulation (Reg. 74, Art. 66) which is under consideration in the instant case.

In *United Drug Co. v. Nichols*, 21 F. (2d) 160 (1927), the Court proceeded on the theory of consolidated unity between affiliated corporations, and said:

The entire proceeds from the sale of this stock represented additional capital to the affiliated group—the investment of the new stockholders who purchased the stock. The sale was a capital transaction, which could not give rise to a taxable gain or deductible loss. *Appeal of Farmers Deposit National Bank*, 5 B. T. A. 520.

Thus it is seen that the rule was being urged by the Department in the Board and in the Courts over a long period of years; and that contemporaneously with the Departmental Regulations, and in accordance with Departmental Regulations, Decisions and Rulings, the Board and the Courts, over this same period of years, were giving affirmation and approbation to the rule.

*There is Reason in Support of the Rule.*

Under the Supreme Court Rule it is necessary for the Commissioner, in order to sustain his present position, to establish that the rule adhered to, for these many years, by the Treasury Department, the Board and the Courts, is clearly and plainly wrong and without reason to support it, and that its overthrow is plainly required.

Like many other terms of general purport, "reasonableness" is a comparative term.

It stands to reason that if the rule were devoid of reason, were plainly and clearly wrong, and were utterly untenable,

some one among the various Secretaries, Commissioners, General Counsels, Appeals and Reviews Committees, Legislative Committees, Board of Tax Appeals, and Circuit Courts of Appeals, would have been able to detect it. A rule which has had over 25 years support by text writers and technical authorities, and which has had about 25 years of Departmental approval and application, and over 10 years of approval and application by the Board and the Appellate Courts, can not be said to be "plainly and clearly wrong." The error was not plain or clear enough for detection by the many Administrators and Judges who gave study to the question during those many years.

The Rule was open, notorious, and well recognized for many years. The Regulations and Decisions of the Treasury Department were published. The Decisions of the Board and of the Courts were published. Congress is deemed to know the official construction put upon statutes especially when such constructions are of long and well recognized standing. It was in light of such long and well recognized standing that Congress reenacted the statute without change. In light of Departmental Regulations and Decisions the statute was so reenacted seven times. In light of the authoritative text writers the statute was so reenacted at least seven times. In light of Board and Court decisions on this specific point (beginning in 1925<sup>1</sup>) the statute was so reenacted four times without change.

*The Long Established Doctrine of the Supreme Court is Applicable under the Circumstances.*

The doctrine applicable under the circumstances has been applied by this Court since 1827 (*Edwards v. Darby*, 12 Wheat. 206, 210). The doctrine is grounded on the principle that there should be certainty and repose in matters long since settled. The principle is aptly stated in *Com'rs of Inland Revenue v. Harrison*, L. R. 7 H. L. 1:

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<sup>1</sup> *Borg v. International Silver Co.*, *supra*; *Simmons & Hammond Mfg. Co.*, *supra*; *Cooperative Furniture Co.*, *supra*; *Atlantic Carton Co.*, *supra*.

The object must be, above that of all other acts, to maintain them and to expound them in a manner which will be consistent, and which will enable the subjects of this country to know exactly the charge and burden which they are to sustain. I think that, with regard to statutes of that kind, above all others, it is desirable, not so much that the principle of the decision should be capable at all times of justification, as that the law should be settled, and should, when once settled, be maintained without any danger of vacillation or uncertainty.

The doctrine has been emphasized by this Court in the variety of ways in which it has been expressed.

The most recent expression of the Court was only a month ago.

*Com'r v. Winmill*, — U. S. — (Nov. 7, 1938), involved the interpretation of sec. 23 (a) of the 1932 Act, a section general in its terms allowing expense deductions. Regulations provided that commissions paid in purchasing securities are a part of the cost of the securities. Taxpayer contended that such commissions were deductible as ordinary expenses. The Court said:

Regulations promulgated under the 1916 income tax law treated commissions in security purchases as a part of the securities' cost and not as ordinary expense deductions. *This interpretation has consistently reappeared in all regulations under succeeding tax statutes.\** In the period since 1916 statutes have from time to time altered allowable deductions, but it is significant that Congress substantially retained the original taxing provisions on which these regulations have rested.

*Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law. (Italics supplied.)*

\* [Footnote by the Court.] Art. 293 of T. R. 45 (1918), 62 (1921); Art. 292 of T. R. 65 (1924), 69 (1926); Art. 282 of T. R. 74 (1928), 77 (1932); Art. 24-2 of T. R. 86 (1934), 94 (1936).

The *Winmill case* is nicely in point and rules the instant case. In *United States v. Alabama Great Southern R. Co.*, 142 U. S. 613, the Court said:

We think the contemporaneous construction thus given by the executive department of the Government, and continued for nine years through six different administrations of that department \* \* \* should be considered as decisive in this suit. It is a settled doctrine of this court that, in case of ambiguity, the judicial department will lean in favor of a construction given to a statute by the department charged with the execution of such statute, and, *if such construction be acted upon for a number of years, will look with disfavor upon any sudden change, whereby parties who have contracted with the Government upon the faith of such construction may be prejudiced. It is especially objectionable that a construction of a statute favorable to the individual citizen should be changed in such manner as to become retroactive. \* \* \*. These principles were announced as early as 1827 in Edwards v. Darby, 25 U. S. 12 Wheat. 206, 210 [6 : 603, 604], and have been steadily adhered to in subsequent decisions.* (Italics supplied.)

The foregoing language is quoted with approval in *Luckenbach Steamship Co. v. United States*, 280 U. S. 173.

In *Brewster v. Gage*, 280 U. S. 327, the Court was discussing a Regulation defining the basis for ascertaining a profit on a sale. The Court said:

The Revenue Act of 1918 and subsequent acts taxed incomes of estates during the period of the administration including profits on sales of property. \* \* \*

Treasury Regulations under the revenue acts in force between 1917 and 1928 declared that value at time of the death of decedent should be taken as the basis for ascertaining profit or loss from sale of property acquired by bequest or descent \* \* \*.

These regulations were prepared by the department charged with the duty of enforcing the acts. The rule so established is reasonable and does no violence to the letter or spirit of the provisions construed. A reversal of that

*construction would be likely to produce inconvenience and result in inequality. It is the settled rule that the practical interpretation of an ambiguous or doubtful statute that has been acted upon by officials charged with its administration will not be disturbed except for weighty reasons. [Citing cases.] \* \* \**

*The substantial re-enactment in later acts of the provision theretofore construed by the department is persuasive evidence of legislative approval of the regulation. [Citing cases.] The subsequent legislation confirmed and carried forward the policy evidenced by the earlier enactments as interpreted in the regulations promulgated under them. (Italics supplied.)*

In *Copper Queen Consol. Min. Co. v. Arizona*, 206 U. S. 474, Mr. Justice Holmes states the rule thus:

And again, when, for a considerable time, a statute notoriously has received a construction in practice from those whose duty it is to carry it out, and afterwards is reenacted in the same words, it may be presumed that the construction is satisfactory to the legislature, unless plainly erroneous, since otherwise naturally the words would have been changed.

In *United States v. Cerecido Hermanos y Compania*, 209 U. S. 337, the Court repeats the rule:

We have said that, when the meaning of a statute is doubtful, great weight should be given to the construction placed upon it by the department charged with its execution. \* \* \* And we have decided that the reenactment by Congress, without change, of a statute which had previously received long-continued executive construction, is an adoption by Congress of such construction. (Italics supplied.)

*McCaughn v. Hershey Chocolate Co.*, 283 U. S. 488, is aptly in point. The Court said:

Possible doubts as to the proper construction of the language used should be resolved in the light of its administrative and legislative history. \* \* \*

The administrative construction was upheld in 1922 by

Malley v. Walter Baker & Co. (C. C. A. 1st) 281 Fed. 41, supra, the only case, other than the present, which has considered it. The provision has been consistently enforced as construed, was re-enacted by Congress in the 1921 Act, and remained on the statute books without amendment until its repeal. Such a construction of a doubtful or ambiguous statute by officials charged with its administration will not be judicially disturbed except for reasons of weight, which this record does not present. [Citing cases.] *The re-enactment of the statute by Congress, as well as the failure to amend it in the face of the consistent administrative construction, is at least persuasive of a legislative recognition and approval of the statute as construed.* (Italics supplied.)

*Massachusetts Mutual L. Ins. Co. v. United States*, 288 U. S. 269, involved a regulation promulgated under sec. 245 of the 1921 Act. The regulation was carried forward under two succeeding revenue acts which were enacted without change. The Court said:

It [Government] further points to a regulation adopted immediately upon the passage of the Act of 1921 and carried forward in the regulations under the Acts of 1924 and 1926. This regulation is: \* \* \*

The Congress in the Revenue Acts of 1928 and 1932 reenacted §245 without alteration. This action was taken with knowledge of the construction placed upon the section by the official charged with its administration. *If the legislative body had considered the Treasury interpretation erroneous it would have amended the section. Its failure so to do requires the conclusion that the regulation was not inconsistent with the intent of the statute [citing cases] unless, perhaps, the language of the act is unambiguous and the regulation clearly inconsistent with it.* (Italics supplied.)

In *Murphy Oil Co. v. Burnet*, 287 U. S. 299, 322, the Court said:

Doubts, if any, whether the statute authorizes depletion of bonus payments, have been definitely set at rest by the

repeated re-enactment, without substantial change, of the provisions of §234 (a) (9), since the promulgation of treasury regulations providing for such depletion.

In *National Lead Co. v. United States*, 252 U. S. 140, the Court said:

During all the intervening twenty-four years this rule of the Department with respect to drawbacks had been widely applied to many articles \* \* \*. *The reenacting of the drawback provision four times, without substantial change, while this method of determining what should be paid under it was being constantly employed, amounts to an implied legislative recognition and approval of the executive construction of the statute \* \* \* for Congress is presumed to have legislated with knowledge of such an established usage of an executive department of the government. (Italics supplied.)*

In *Universal Battery Co. v. United States*, 281 U. S. 580, the Court said:

*This construction of those terms has been adhered to in the Internal Revenue Bureau for about ten years and it ought not to be disturbed now unless it be plainly wrong. (Italics supplied.)*

In *United States v. Farrar*, 281 U. S. 624, the defendant was indicted as a purchaser of liquor, under the Prohibition Act. The Court said that:

\* \* \* during \* \* \* a period of ten years executive departments charged with the administration \* \* \* of the act have uniformly construed it as not including the purchaser \* \* \*; no prosecution until the present one has ever been undertaken upon a different theory; and Congress, of course well aware of this construction and practice, has significantly left the law in its original form.

In *United States v. Jackson*, 280 U. S. 183, Mr. Chief Justice Taft stated the rule clearly and succinctly:

It is a familiar rule of statutory construction that great weight is properly to be given to the construction consistently given to a statute by the Executive Department charged with its administration [citing cases]; *and such construction is not to be overturned unless clearly wrong, or unless a different construction is plainly required.* (Italics supplied.)

In *Fawcus Machine Co. v. United States*, 282 U. S. 375, the regulations prescribed a formula for computing invested capital. The Court said that the regulations were made pursuant to express authority in the Revenue Act, that they were entitled to respectful consideration, and that they "*will not be overruled except for weighty reasons.*"

The following cases are deserving of especial consideration because of their great similarity in point of fact with the instant case.

*Old Colony R. Co. v. Com'r*, 284 U. S. 552, is particularly apt since the regulation there in question bore upon the same section of the act as herein—the general definition of gross income. The Regulations had for a long time construed the section to mean that the net amount of premium at which bonds were issued was gain which should be amortized over the life of the bonds. The Commissioner attempted to change his construction. This Court denied his right to do so, saying:

*The regulations state that the net amount of premium is gain or income. Necessarily, then, the premium is gain or income of the year in which it is received. The provisions of the Revenue Acts of 1918, 1921, 1924 and 1926 are the same as respects gross income of corporations and deductions therefrom. The regulations under the relevant sections of the acts of 1918, 1924 and 1926 employ substantially the same phraseology as that found in those issued under the 1921 act. The repeated reenactment of a statute without substantial change may amount to an implied legislative approval of a construction placed upon it by executive officers.* (Italics supplied.)

The Court then added:

If there were doubt as to the connotation of the term, and another meaning might be adopted, the fact of its use in a tax statute would incline the scale to the construction most favorable to the taxpayer [Citing *Gould v. Gould*, 245 U. S. 151, and several other cases to the same effect.]

The close analogy of the above case should make it controlling.

*Helvering v. Bliss*, 293 U. S. 144, is also in point with the instant case. It deals with the construction of the sections defining income, relates to the year 1928, and involves the same statute as is here involved.

In that case, as in the instant case, the sections of the statute defining income had remained substantially unchanged through several reenactments of the statute. The taxpayer argued that capital gains should be excluded from the income upon which is to be calculated the deductible percentages of charitable contributions. The Commissioner argued that the rulings and practice of the Bureau from 1917 to 1932 had consistently allowed deductible percentages for charitable contributions against all of taxpayers' net income including capital gains, and that the reenactment of the statutes without substantial change had approved and adopted that construction. The Court concluded that the Commissioner's rulings were tenable and had support in reason and said:

Moreover, from 1923 to 1932 the Commissioner uniformly ruled that the deduction for charitable contributions was to be taken from net income before computation of the tax and hence in whole from ordinary net income. The reenactment in later Acts of the sections permitting the deduction indicates Congressional approval of this administrative interpretation.

In the *Bliss* case the Government made the same argument to the Supreme Court which the petitioner is now making to this Court, and insisted upon the application of the principle for

which the instant petitioner contends. The Supreme Court sustained and approved the Government's position there and its opinion and decision thereby sustain and approve the same position here taken by the petitioner.

*Old Mission P. Cement Co. v. Helvering*, 293 U. S. 289, is also in point. There a corporation contended for a deduction on account of charitable contributions. The Commissioner contended that Departmental Regulations (Art. 562 of Reg. 62) provided to the contrary and that this regulation was retained in subsequent regulations promulgated under succeeding revenue acts. The Court said:

The privilege of deducting charitable donations from gross income, conferred on individual taxpayers by §214 (a) of the Revenue Acts of 1921, 1924 and 1926, has not been extended to corporations. \* \* \* Section 234 (a) (1) of the Revenue Acts of 1921, 1924 and 1926, authorizes corporations to deduct from gross income "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." Article 562 of Treasury Regulations 62, interpretative of the 1921 Act, declared that corporations were not entitled to deduct charitable donations. \* \* \* *These provisions were retained, without substantial change, in the regulations promulgated under the 1924, 1926 and 1928 Acts. Art. 562 of T. R. 65, 69; Art. 262 of T. R. 74. As §234 (a) (1) to which they pertain has been reenacted in several revenue acts, the regulation now has the force of law. (Italics supplied.)*

In *Hartley v. Com'r*, 295 U. S. 216, the question was the basis for determining gain or loss on the sale of property by a decedent's estate, whether date of acquisition of the property by the executor, or date of death of decedent. Abstractly there appeared to be doubt as to the answer. The Court said:

Possibility of doubt was removed by treasury regulation. Article 343 of Regulation 45, under the 1918 Act, prescribed that gains or losses of an estate should be computed on the basis of the value of the property at the date of the

decendent's death. This was carried forward by Art. 343 of Reg. 62 under the Act of 1921, of Reg. 65 under the Act of 1924, and of Reg. 69 under the Act of 1926. \* \* \* The substance of the regulation in its original and final form was carried into §113 (a) (5) of the Revenue Act of 1928, chap. 852, 45 Stat. at L. 791, 819, U. S. C. title 26, §2113, \* \* \*

The reenactment of the pertinent provisions of §202 of the Revenue Act of 1921 in the Acts of 1924 and [February, 1926] 1926 [44 Stat. at L. 11, chap. 27, U. S. C. title 26, §933], without material change, was a congressional recognition and approval of the interpretation of the section by the treasury regulations, which gave them the force of law. [Citing *Old Mission case*, *supra*, and *Brewster v. Gage*, *supra*.]

In *McFeely v. Com'r*, 296 U. S. 102, the question was the basis for determining a profit on the sale of property acquired from a decedent. The Court said:

*The Commissioner has heretofore administered the section upon this theory. As respects the Revenue Act of 1921, he so ruled in 1923 [I. T. 1600, C. B. II-1, 36; I. T. 1719, C. B. II-2, 45] and again in a very full memorandum in 1924 [I. T. 1889, C. B. III-1, 70; O. 1012, 2 C. B. 34; P-H Tax Service, 1923, 2703-4] \* \* \*. The repetition of the definition without material change in the subsequent acts, including that of 1928, amounts to a confirmation of the administrative interpretation. There is nothing in the section, its history, or the administrative practice, to enlarge or alter the connotation commonly ascribed to the word 'held.'* \* \* \*

No change was made in the phraseology of §101 (c) (8) from that used in prior acts defining capital assets as "property held by the taxpayer \* \* \* for more than two years." \* \* \* The Committee Reports disclose no purpose to alter the rule laid down in the earlier statutes and reenacted in §101 (a) (8). Congress must be taken to have been familiar with the existing administrative interpretation. (Italics supplied.)

The foregoing case presents a case where the Commissioner

was attempting, as in the instant case, to apply a different rule from that followed persistently for a long period.

In *Koshland v. Helvering*, 298 U. S. 441, the Court said:

\* \* \* We give great weight to an administrative interpretation long and consistently followed, particularly when the Congress, presumably with that construction in mind, has reenacted the statute without change [citing *Poe v. Seaborn*, 282 U. S. 101, 116; *McCaughn v. Hershey*, *supra*; *McFeely v. Com'r*, *supra*] \* \* \*.

\* \* \* Where the act uses ambiguous terms, or is of doubtful construction, a clarifying regulation or one indicating the method of its application to specific cases not only is permissible but is to be given great weight by the courts. *And the same principle governs where the statute merely expresses a general rule*<sup>1</sup> and invests the Secretary of the Treasury with authority to promulgate regulations appropriate to its enforcement. (Italics supplied.)

Two members of the Court dissented from the *decision* in that case but indicated their views on the subject-matter here under discussion, as follows:

The meaning of the Act of Congress \* \* \* has had a practical construction through administrative action and legislative acquiescence. *Even though the meaning may have been uncertain in the beginning*, it has now become fixed in accordance with long continued practice. *Morrissey v. Commissioner*, 296 U. S. 344, 355; *Helvering v. Minnesota Tea Co.*, 296 U. S. 378, 384. (Italics supplied.)

The doctrine is aptly summarized in *United States v. Finnell*, 185 U. S. 236. There a clerk had been paid commissions for services over a period of years and then the Treasury Department sought to change the basis of his compensation. The Supreme Court held that this could not be done, *even though originally the question might have been a doubtful one*, saying (p. 244):

<sup>1</sup> As noted *supra*, Sec. 22 (a) is expressly stated to be a "General definition."

\* \* \* Of course, if the departmental construction of the statute in question were obviously or clearly wrong, it would be the duty of the court to so adjudge. \* \* \* But if there simply be doubt as to the soundness of that construction,—and that is the utmost that can be asserted by the government,—the action during many years of the Department charged with execution of the statute should be respected, and not overruled except for cogent reasons.

One of the most exhaustive discussions of this principle is found in *Walker v. United States* (C. C. A. 8, 1936), 83 F. (2d) 103. In that case a regulation of long standing was in force at decedent's death. Thereafter the Commissioner promulgated a new regulation entirely contrary to the former one, and contended that the former regulation was plainly wrong. The Court reviewed the history and logic of the principle here involved and said:

The weight or force which the courts will \* \* \* give to such executive or legislative construction, has been variously phrased by the Supreme Court. Similarly, there is a variety of expression as to such weight and force where the court conceives the executive construction to be also approved by Congress. In such latter situation, it has been said that the executive construction has the "force of law" [citing cases]; that it "must be accepted" [citing cases]; that it "will not be overturned except for very cogent reasons" [citing cases]; that it would be given "great weight, even if we doubted the correctness of the ruling" [citing cases]; that it will not be "disturbed except for reasons of weight" [citing cases]; that "were the matter less clear" the court "should be constrained" to follow it [citing cases]; that it will be followed "when not plainly erroneous" [citing cases]. When the quotations in the above sentence are considered in connection with the issues and situations in which they were severally used, it would seem that a safe statement of the rule of construction is that, where a statutory provision is ambiguous, and the executive department which must apply and enforce it declares a construction (not in itself ambiguous \* \* \*) for administrative purposes, and thereafter Congress reenacts the provision without substantial change, the courts will

accept that construction unless it be "plainly erroneous."  
\* \* \* (p. 106-107.)

In applying this rule, we find an ambiguity of meaning in this respect; that the department has consistently and continuously recognized the effect of payment by the beneficiary; that the Congress has re-enacted this identical language while such departmental construction thereof was being applied in administration; that the Supreme Court has strongly intimated that the source of premiums was an element in the subjection of life insurance proceeds to such character of tax. Obviously, we can not in such situation say (nor would we do so independently thereof) that Regulation 70 is so "plainly erroneous" as a construction of the act that we should reject it. \* \* \* (p. 109.)

\* \* \* But, if the courts consider themselves bound to follow executive constructions approved by congressional re-enactment unless such constructions are "plainly erroneous," it must follow that they should consider the executive similarly bound and regard such subsequent construction by the executive from that standpoint. \* \* \* (p. 109.)

Here, Regulations 80 is, in part, a reversal or at least a limitation of Regulations 70. \* \* \* At least it is clear that Regulations 80 has not revealed a standard which shows Regulations 70 to be "clearly erroneous." The result is that the later regulation can not, under the situation here, be held to replace or change the effect of the earlier regulation; \* \* \* (p. 109). (Italics supplied.)

The foregoing leaves no doubt as to what the rule is, or as to its application to the facts in the instant case. *Every element which was pointed to as controlling in the above case is present in the instant case.*

*The Decision of the Court Below in the Instant Case Was Pursuant to the Foregoing Principle.*

The Court below rendered its decision in light of the administrative and legislative history of the Regulation, and in light of the legal and technical authorities supporting it. The decision of the Court below was specifically grounded on the foregoing principles.

The Court below reviewed the authorities supporting the

long continued Treasury Regulations—the technical, the legal, and the administrative authorities. The Court found (R. bot. 73) that:

During a period of sixteen years from 1918 to 1934, the regulations, rulings and decisions of the Treasury Department and the decisions of the Board of Tax Appeals supported the interpretation of the statute for which the taxpayer now contends. \* \* \* Thus the regulations in force during the period expressly declare that "a corporation realizes no gain or loss from the purchase or sale of its own stock"; the rulings and decisions of the Treasury Department were in harmony with this pronouncement.

The Court further found (R. 74, and marginal notes) that the decisions of the Board of Tax Appeals were likewise in harmony therewith.

The Court further found (R. 74) that writers upon the theory of accounting have given much consideration to the proper method of treating such transactions and that it is quite generally said that stock purchased and held as treasury stock should not be treated as an asset.

The Court further noted (R. 74, note 11) that the Federal Securities & Exchange Commission ruled that the excess of the proceeds of the sale of reacquired shares of a corporation's own stock, over the cost thereof, should be accounted for as capital since a transaction of this nature does not result in profit.

The Court quoted the opinion in *Borg v. International Silver Co.* and noted other decisions in conformity therewith.

After thus reviewing the history and application of the Regulation, and the authorities supporting it, the Court below determined that (R. 76-77) neither interpretation of the Act is without a reasonable basis: that it is reasonable to say that when a corporation buys or sells its own stock, a change in the capital structure takes place; and that, on the other hand, it might be said that an increase or decrease of resources which accompanies such transactions bears resemblance to recognizable gain or loss. The Court concludes:

There is room for debate, and this situation determines the rationale of our decision in the pending case.

Upon the foregoing premise the Court below followed literally the mandates of this Court that: "Possible doubts as to the proper construction of the language used should be resolved in the light of its administrative and legislative history."<sup>1</sup> "The Commissioner has heretofore administered the section upon this theory. \* \* \* The repetition of the definition without material change in the subsequent acts, including that of 1928, amounts to a confirmation of the administrative interpretation."<sup>2</sup> "It is especially objectionable that a construction of a statute favorable to the individual citizen should be changed in such manner as to become retroactive \* \* \*."<sup>3</sup> " \* \* \* the reenactment by Congress, without change, of a statute which had previously received long-continued executive construction, is an adoption by Congress of such construction."<sup>4</sup> "These provisions were retained, without substantial change, in the regulations promulgated under the 1924, 1926 and 1928 Acts. \* \* \* As §234 (a) (1) to which they pertain has been reenacted in several revenue acts, the regulation now has the force of law."<sup>5</sup> "This construction of those terms has been adhered to in the Internal Revenue Bureau for about ten years and it ought not to be disturbed now unless it be plainly wrong."<sup>6</sup> "This interpretation has consistently reappeared in all regulations under succeeding tax statutes. \* \* \* it is significant that Congress substantially retained the original taxing provisions on which these regulations have rested. Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes are deemed to have received congressional approval and have the effect of law."<sup>7</sup>

<sup>1</sup> *McCaughn v. Hershey Chocolate Co.*, 283 U. S. 488, 492.

<sup>2</sup> *McFeely v. Helvering*, 296 U. S. 102, 108.

<sup>3</sup> *United States v. Alabama Great Southern R. Co.*, 142 U. S. 615, 622.

<sup>4</sup> *United States v. Cerecido Hermanos y Compania*, 209 U. S. 337, 339.

<sup>5</sup> *Old Mission P. Cement Co. v. Helvering*, 293 U. S. 289, 293-294.

<sup>6</sup> *Universal Battery Co. v. United States*, 281 U. S. 580, bot. 583.

<sup>7</sup> *Com'r v. Winmill* — U. S. — (Nov. 7, 1938).

The Court below applied all of the foregoing injunctions of this Court to the circumstances herein and said:

But, as we have seen, the prevailing opinion in that year [1918] and thence continuously until 1934 forbade the taxation of such a profit as the Tobacco Company earned in 1929 in the sale of its own stock; and Congress in light of this interpretation of its intent reenacted in substantially the same words the definition of income subject to tax in five successive carefully considered revenue acts (R. mid. 77).

Having held that the long continued construction of the Regulations and Decisions was not without a reasonable basis and was not plainly and obviously wrong, the Court below stated the rationale of its decision as follows:

Our path is therefore clear: for the rule is well settled that if a statute is reasonably susceptible of two constructions, its reenactment after an interpretative ruling by responsible officials amounts to a legislative sanction of the course pursued. Especially is this true when the construction has been long maintained and several reenactments of the language in dispute have taken place. The rule has been frequently applied in cases under the revenue acts when the statutory language is in general terms and susceptible of different interpretation as applied to the relevant facts; and in *Johnson v. Commissioner*, 56 F. (2d) 58, (C.C.A. 5) 1932, it was applied to the very regulation now under consideration as set out in Regulations 62, Article 543 relating to the Revenue Act of 1921.

The Court below was correct in following the established rule of this Court in such circumstances.

*The Instant Case Presents No Exception to the Established Rule of This Court.*

Sec. 22 (a) of the 1928 Act is a *general definition*<sup>1</sup> of income.

<sup>1</sup> Sec. 22 (a) of the Act specifically so designates it.

It is not proper to classify it as "ambiguous" or as "unambiguous." As in all such general statutory definitions it is the duty of the Department to indicate the method of its application to specific cases. This Court has said that "where the statute merely expresses a general rule and invests the Secretary of the Treasury with authority to promulgate regulations," "a clarifying regulation or one indicating the method of its application to specific cases" will be given great weight by the courts.<sup>1</sup> This Court has also said that where the Department has long continued to administer a general definition by specific construction, such construction must not be altered unless the section, its history, and the administrative practice, shows it to be violative of the plain and unequivocal meaning of the statute.<sup>2</sup> This Court has held that possible doubts as to such construction must be reviewed in the light of its administrative and legislative history.<sup>3</sup>

Sec. 22 (a) being a "general" definition, the Secretary construed it under the power with which he was invested so to do. The foregoing rule of this Court is specifically applicable.

*The Decision Below is Supported by the Recent Decision in the Squibb Case.*

On July 12, 1938, the Circuit Court of Appeals for the Second Circuit rendered a decision in *E. R. Squibb & Sons v. Helvering*, 98 F. (2d) 69. To the extent the shares therein were reacquired and reissued at the open market price, the facts of that case are similar to those herein. That case arose under sec. 22 (a) of the 1932 Act which is identical in terms with sec. 22 (a) of the 1928 Act. The Regulations under the two Acts were likewise identical.

In that case the Court discussed at length the soundness of the long continued regulations and decisions, and demonstrated

<sup>1</sup> *Koshland v. Helvering*, 298 U. S. 441, 447, 446. Cf. *Maryland Casualty Co. v. United States*, 251 U. S. 342, 349, 350.

<sup>2</sup> *McFeely v. Helvering*, 296 U. S. 102, 108; also *Com'r. v. Winmill*, *supra*.

<sup>3</sup> *McCaughan v. Hershey Chocolate Co.*, 283 U. S. 488, 492.

that they were supported by logic and reason and that their interpretation of the statute was at least permissible.

That discussion by the Court is enlightening and persuasive, and for the convenience of this Court the decision in that case is set forth in Appendix B, *infra* pp. 70.

The conclusion of the Court is: (1) the long continued regulations were not untenable but were permissible as reasonable; (2) they had received an authoritative interpretation through the long acquiescence of Congress and repeated reenactments of the statute without change; and (3) the changed regulations are not applicable to the instant transactions which did not constitute a dealing in its own shares as it might in the shares of another corporation.

The Court concluded that "the uniform interpretation, so long placed upon §22 (a), \* \* \* by the regulation and confirmed by the inaction of Congress, was imbedded in the statute so deep that only legislation could dislodge it."

The decision in the *Squibb case* is in accord with the rule of this Court. It is logical and persuasive, and supports the decision in the instant case.

#### *The Recent Decision in the Case of First Chrold Corporation is Not Persuasive.*

On May 26, 1928, the Circuit Court of Appeals for the Third Circuit decided the case of *First Chrold Corp'n v. Com'r*, 97 F. (2d) 22. In that case the Court did not pass upon or decide the issue presented in the instant case, viz: whether the long continued interpretation put upon the statute by the regulations and decisions should be overthrown.

The Court approached the question by stating: "We treat the case as presenting but one question." The Court then stated the question to be whether or not a corporation realized a taxable profit when it acquired shares of its own stock and reissued them for a price above the acquisition price. The Court treated the case as one of first impression, ignoring the fact that it was not a case of first impression. The Court made no mention of the Regulations, existing since 1918, upon which

the taxpayer relied in making its transaction. - The Court made no mention of the many Departmental Rulings and Decisions applying that regulation. The Court made no mention of the authorities, cases and decisions tending to show that there was reason, logic and authority to support that construction. The Court did not decide or hold that the old and long continued construction was clearly and obviously wrong and untenable.

That decision held only one thing. It held only that, viewed as a matter of first impression, shares of stock are *thought of* as property, because shares can be bought and sold; that a corporation may buy and sell its own shares as it does other kinds of property, in a *practical* sense; that in such case it ignores the fact that it is its own stock; that this is so because corporations are known to do it; that when a corporation buys and sells its own stock it constitutes an "as if" transaction, i. e., in such cases the corporation buys and sells them "*as if*" *they were not the corporation's own shares*. The Court concludes that this in no way affects the capital of the corporation because it is assumed that, if the shares were not the corporation's own shares, the transaction would be taxable, but since they *were* the corporation's own shares, they would, notwithstanding, be considered "as if" they *were not*. The Court cites no authority for its view. The Court, in effect, says that, as an abstract proposition of first impression, such a transaction ought to be taxed.

It is not necessary here to decide whether the above decision would have been abstractly correct if it had been decided in 1918. Neither is it necessary to decide here whether the decision below in *the instant case* would have been abstractly correct if it had been decided in 1918.

The instant case was decided by applying the rule of this Court in light of administrative, legislative and political history as it exists to-day.

The *Chrold* case was not decided on that basis and is not persuasive on the issue presented herein. (See Respondent's Brief in Opposition to Certiorari, pp. 1-2, 15-17, 19-20.)

*A Construction of a Statute Should Not Be Adopted which Leads to Unjust, Oppressive or Inconsistent Results, and Which Does Violence to the Rule of Uniformity of Taxation.*

The instant petition for certiorari states that there are six similar cases pending in the Board and at least eighteen in the Bureau. The taxpayer does not have the advantage of statistics but respectfully suggests to the Court the following:

For about 25 years the Commissioner administered this section under his rulings that the instant transactions were capital transactions and not income transactions. For 16 years of that time his Regulations so provided. During about 10 years of that period he maintained and defended that position in the Board of Tax Appeals and in the Courts, in a large number of cases. During that period the statute was repeatedly reenacted without change. Obviously every tax case in which this principle was applied was not made the subject of a published Departmental ruling or Board decision. It is reasonable to suggest, therefore, that his long continued construction has been applied to thousands of cases; that thousands of taxpayers have had their taxes adjusted by the Commissioner under those regulations and rulings; that other thousands of taxpayers made their returns in accordance with those regulations and no tax case arose upon them. The cases of all those thousands of taxpayers are now closed. By applying his construction over this long period of years the Commissioner has unquestionably collected vast amounts of money in taxes.

The Commissioner now seeks to apply *retroactively* an opposite rule. He seeks to apply such opposite rule retroactively to 1924. That is now a period of 14 years. His petition says there are now about 24 cases. This is an average of slightly less than two cases per year since 1924.

The retroactive change of construction contended for by the Commissioner would violate a long established doctrine of this Court relative to uniformity of taxation. According to the petition herein a very negligible fraction of taxpayers' cases, which have arisen on this point since 1918, are now involved.

Practically all of them are finally closed by the statute of limitations. It would be unjust and oppressive to the remaining few to apply a rule totally opposite to, and inconsistent with, the rule applied to practically all the similarly circumstanced taxpayers through all these years of the administration of the section in question.

The present attempt of the Commissioner to collect taxes from one group of taxpayers on one basis, and from another group similarly circumstanced on another basis, does not present the case of a sporadic or inadvertent mistake on his part, which the Court will not view as deliberate. On the contrary, his interpretation and application of one rule of construction has been studied, deliberate, uniform and consistent over a period of many years. His attempt now to change that rule and apply such change retroactively to a small group of taxpayers whose transactions were made in the light of his former construction, is deliberate and not inadvertent. It is a studied attempt to apply a different rule of taxation to a small remaining group of taxpayers.

The courts have uniformly felt strongly and talked plainly about such discriminations and lack of uniformity, by taxing authorities, between taxpayers similarly circumstanced. They have withheld judicial rectification of such discriminations only when they have been shown plainly to be accidental and inadvertent, and to have come about without the design or intent of the taxing authority. But where the discrimination complained of is shown to be the result of knowing, conscious and deliberate action on the part of the taxing authority, where the discrimination is shown to be the result of the application by the taxing authorities of two different rules, principles, or standards, and thus to be inescapably due to design and intent on the part of the taxing authorities;—under such circumstances the courts have consistently refused to countenance such action and have, when necessary, relieved against such discrimination.

And even where it is unmistakably shown that the rule, principle, standard or method applied to one group of taxpayers

is doubtful, erroneous, unlawful and not in accordance with the statute, the courts have not hesitated to correct an intentional discrimination by applying the same rule, principle, standard or method to another group of taxpayers. The intentional misuse of the taxing power to bring about inequality of tax burden between citizens has so outraged the Anglo-Saxon sense of justice that the courts have destroyed such inequalities or refused to permit them to be perpetrated, even though they had to override the abstractly plain words of a taxing statute to do so.

The rule against discriminations, inequality, lack of uniformity, and unjust and oppressive results has been repeatedly stated. *United States v. Kirby*, 7 Wall. 482, 486; *Ilfeld Co. v. Hernandez*, 292 U. S. 62, 68; *Savings and Loan Ass'n v. Topeka*, 20 Wall. 655; *Reagan v. Trust Co.*, 154 U. S. 362, 390; *Sioux City Bridge Co. v. Dakota County*, 260 U. S. 441; *Ozawa v. United States*, 260 U. S. 178, 194; *United States v. Alabama Great Sou. R. Co.*, 142 U. S. 615, 622; *Brewster v. Gage*, 280 U. S. 327, bot. 336; *Taylor v. L. & N. R. Co.*, 88 Fed. 350; *Railroad and Telephone Cos. v. Board*, 85 Fed. 302, bot. 307; *County of Santa Clara v. Railroad Co.*, 18 Fed. 385, 399; *Louisville & N. R. Co. v. Bosworth*, 230 Fed. 191, 209; *State v. Taylor*, 35 N. J. Law 184; *People ex rel. v. City of Chicago*, 152 Ill. 546, 552; *Supervisors v. Railroad Co.*, 44 Ill. 229; *Ex parte Bridge Co.*, 62 Ark. 461; *Com'rs of Inland Revenue v. Harrison*, L. R. 7 H. L. 1; *Lewis' Sutherland Statutory Construction*, Vol. 2 (2d Ed. 1904), sec. 489, p. 913.

In *Bingham v. United States*, 296 U. S. 211, this Court quoting with approval from *Lewellyn v. Frick*, 268 U. S. 238, said:

This court applied the rule that acts of Congress are to be construed, if possible, so as to avoid grave doubts as to their constitutionality; and said that such doubts were avoided by construing the statute as referring only to transactions taking place after it was passed. In that connection we invoked the general principle "that the laws are not to be considered as applying to cases which arose before their passage" when to disregard it would be

to impose an unexpected liability that, if known, might have been avoided by those concerned.

And in *United States v. Flannery*, 268 U. S. 98, this Court said that: "Decisions affecting the business interests of the country should not be disturbed except for the most cogent reasons."

In *United States v. Kirby*, *supra*, it was said: "*General terms should be so limited in their application as not to lead to injustice, oppression, or an absurd consequence.*" In *Ilfeld v. Hernandez*, *supra*, it was said: "If allowed, this would be the practical equivalent of double deduction. In the absence of a provision of the Act definitely requiring it, a purpose so opposed to precedent and equality of treatment of taxpayers will not be attributed to lawmakers."

In *Brewster v. Gage*, *supra*: "The rule so well established is reasonable and does no violence to the letter or spirit of the provisions construed. A reversal of that construction would be likely to produce inconvenience and result in inequality." In *United States v. Alabama Great Sou. R. Co.*, *supra*, it was stated that the judiciary leans in favor of departmental construction and that "if such construction be acted upon for a number of years, will look with disfavor on any sudden change," and that: "It is especially objectionable that a construction of a statute favorable to the individual citizen should be changed in such manner as to become retroactive. \* \* \*" The Court added: "These principles were announced as early as 1827 \* \* \* and have been steadily adhered to in subsequent decisions." See also *National Bank v. Whitney*, 103 U. S. 99, 102; *Hassett v. Welch*, 303 U. S. —.

The taxpayer respectfully submits that the attempt of the Commissioner to invalidate retroactively his Regulations and Rulings of many years standing would result in unjust, oppressive, and inconsistent results, would do violence to the rule of uniformity of taxation and would work a discrimination as between taxpayers similarly circumstanced.

The decision of the Court below in the instant case is in conformity with all the principles discussed hereinabove, and should be affirmed.

## RESPONDENT'S ANSWER TO PETITIONER'S BRIEF.

Taxpayer had prepared its brief *supra* before receiving copy of the Government's brief and here appends its answer thereto.

*The Instant Transaction Did Not Give Rise to Income.*

The Commissioner argues (Bf. 20-26) that because the definition of income is general it must be construed to cover this case. He quotes cases to the effect that "income" is to be given the meaning commonly understood, and as used in its ordinary and usual sense. It would appear a sufficient answer to that argument to say that for many years the proceeds from the sale of stock has been commonly understood not to represent income to the corporation issuing it. For many years it has been commonly understood by practically all the authorities, by the Treasury Department, by the Board, and by the Courts, that such was *not* its meaning. It was in light of that common understanding that Congress enacted and repeatedly reenacted the statute. The Court below found that such was the "prevailing opinion" (R. 77). See p. 41, *supra*.

Whether Congress could levy a tax upon such proceeds, as income, is at least highly debatable. Under the 16th Amendment, Congress may tax only that which is real, genuine, and actual income. Congress can ~~not tax~~ mere enrichment, as petitioner's brief would seem to imply. A man might pay \$100 for a tract of land and bring in an oil well and tank a million gallons of oil. He is certainly enriched but he does not have taxable income. A corporation might have as its only asset a patent of nominal value, but due to public optimism as to its merits, the corporation might sell \$1,000,000 worth of stock and receive the money. It is certainly enriched but it does not have taxable income. A judge of a United States Court might receive a salary which enriched him, but he was not in receipt of taxable income until Congress specifically said so. The sale, at a large profit, of property acquired before March 1, 1913, constituted an enrichment by the realization of the

appreciation before that date, but it is not taxable income. A man may perform a valuable service for a fixed compensation. When he has completed it he is enriched by an account receivable which he can sell. But if he is on a cash basis he does not have taxable income. A man might pay \$100 for a share of stock in a corporation which later piled up a surplus of many millions. The corporation might issue to him (as a stock dividend) shares of stock with a market value of many thousands. He is enriched but he has no taxable income. *Eisner v. Macomber, supra.*

In short, neither the Congress, nor the Courts, nor the Commissioner can extend the definition of income so as to lay a tax on something which is not income. The Amendment does not extend to everything. In the *Macomber case* (the Court, speaking of the Amendment, said:

A proper regard for its genesis, as well as its very clear language, *requires also that this Amendment shall not be extended by loose construction \* \* \*. (Italics supplied.)*

This Court has steadfastly maintained that the statutory definition of income will not be stretched to include "receipts" which do not constitute income.

The argument of petitioner that the taxpayer was in "receipt" of cash when it issued its own stock, and that it was enriched by such receipt, does not meet the issue in this case. Such cash has not commonly, ordinarily, or usually been understood to constitute income, and quite obviously Congress did not so understand it.

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#### *A Corporation Does Not Own a Proprietary Interest in Itself.*

Petitioner (Bf. bot. 26-27) asserts that it "can not be said that Treasury shares are not property from the standpoint of the corporation." He cites no authority for his statement. The answer to that assertion is that *it can be so said.* The

Treasury Department has said it for years. In *A. R. R. 693, supra*, the Treasury Department said:

Treasury stock wherever and whenever that term is used in connection with the accounts of the corporation *or for income tax purposes*, will be held to mean stock which had been previously issued by the corporation and which had been repossessed by it through purchase or otherwise, and then carried on its books as an asset. (*Italics supplied.*)

The same Ruling analyzed the authorities and concluded:

\* \* \* the transaction \* \* \* was a capital one and *not one* in which there resulted a loss from the sale, exchange or other disposition of *property* \* \* \*. (*Italics supplied.*)

In *A. R. R. 799, supra*, the exact question was whether treasury stock was an asset. The taxpayer contended it was. The Department again discussed at length the status of treasury stock in connection with the definition of "assets" and concluded that, "It will be seen that the above definition [of assets] can not include a corporation's own stock which it has *purchased* from its stockholders in the open market." (See full quotation, *supra*, p. 18.)

In addition to the foregoing, we have heretofore pointed out that (in addition to the repeated official rulings of the Department) the text writers, the Board, and the courts have said repeatedly that treasury stock is not an asset of the issuing corporation. In *Con'r v. Schoellkopf*, — F. (2d) — (Dec. 5, 1938), aff'g 35 B. T. A. 855, a corporation acquired shares of its own stock from another corporation in a reorganization. Taxpayer argued that the first corporation had acquired "property." The Court rejected that argument, saying:

As to the shares we do not agree; the shares of a company, when transferred to itself, can not properly be regarded as property acquired; the shares are merely extinguished.

A corporation can not have a proprietary interest in itself. It can not own a part of itself as a property asset.

It is clear that the unsupported assertion (that treasury stock is a property asset) is made by petitioner as a predicate for his argument relative to certain cases which are demonstrably not in point.

We have reviewed the long line of authorities holding that taxable gain is not realized by a corporation when it sells its own treasury stock.

A second group of cases, which are in no way in conflict with those above mentioned, hold that where a profit results from a sale of property, *as distinguished from the corporation's own shares*, such profit is taxable even though the buyer uses shares of the seller's stock as a medium of payment. In such cases the courts have clearly pointed out that the taxed profit is on the sale of the property and not because of any dealing in the seller's shares.

Such cases are those cited by petitioner in his brief, viz: *Walville Lumber Co. v. Com'r*, 35 F. (2d) 445; *Com'r v. S. A. Woods Mach. Co.*, 57 F. (2d) 635; *Com'r v. Boca Ceiga Der. Co.*, 66 F. (2d) 1004; *Dorsey Co. v. Com'r*, 76 F. (2d) 339; and *Allyne-Zerk Co. v. Com'r*, 83 F. (2d) 525.

*The Cases Cited by Petitioner Do Not Hold the Original Regulation Invalid as to Its Provisions that a Corporation Realizes No Gain or Loss from the Purchase and Sale of Its Own Stock.*

*Walville Lbr. Co., Supra*, (Pet. Bf. 27) does not question the long continued regulation here under consideration. The Court did not even refer to it. In that case taxpayer had an investment of \$440,000 in the M Co. The principal asset of M Co. consisted of shares of the taxpayer. M Co. was liquidated and dissolved and in that process the taxpayer received back certain shares of its own stock. It claimed a loss on the liquidation of its investment in M Co. The Commissioner

contended that the transaction resulted in a reduction of "invested capital," under a regulation relating to "invested capital." The Court held that actually the taxpayer had an investment of \$440,000 in the stock of another corporation which constituted property in taxpayer's hands; that the liquidation of that investment resulted in a loss; and the incidental fact that the medium employed in the liquidation was in the form of taxpayer's stock, did not change the primary result. The Court reasoned that if M Co. had sold its asset (taxpayer's stock) and distributed the cash, the loss would be apparent, and the fact that the stock was surrendered in lieu of the cash did not change the result. In that case there was no point made that the taxpayer was dealing in its own stock. The decision had no such predicate, and it in no way supports an argument that the long-continued regulation here under consideration was invalid, or that the changed regulation controls in the instant case.

Petitioner cites *Woods Mach. Co., supra*, (Bf. 28) and states that in that case "it was held that the receipt of its own stock by the taxpayer corporation constituted income, the Treasury Regulations to the contrary notwithstanding." Respondent respectfully submits that that statement is erroneous and that that case held no such thing.

In that case the taxpayer collected a debt and thereby realized a profit. The debt was a judgment debt, and the debtor discharged the debt by delivering to the creditor shares of the latter's stock. The Court held that the profit was realized on the collection of the debt, and not upon the incident of the acquisition of shares of stock. The Court pointed out the distinction, saying:

The transaction involved in this case was equivalent to the payment of the debt in cash and the investment of the proceeds by the corporation in its own stock. If that had been done clearly the cash received would have been taxable income. The transaction was not changed in its essential character by the fact that, as the debtor happened also to own the stock, the money payment and the purchase of

*the stock were by-passed, and the stock was directly transferred in payment of the debt. The stock was the medium in which the debt was paid. (Italics supplied.)*

Nowhere in that decision was the long continued regulation held invalid. The Court merely held that it was not applicable. That case was first decided by the Board, 21 B. T. A. 818, 820. There the majority held that the case was ruled by *Simmons & Hammond Mfg. Co., supra*, and the existing regulations. Six dissenters contended the regulations were sound and that *Simmons & Hammond* was sound, but that *Woods Mach. Co.* did not come under that rule. The dissenters said:

\* \* \* The essential thing is that a liability owing to the taxpayer for the use of its property is being liquidated. and that which is received in liquidation is income. *Such is not the case where the taxpayer buys or sells its own stock for cash, for in neither transaction is there a liquidation of a liability owing to it. \* \* \**

The real question for decision is whether petitioner realized income *as the result of the infringement of its patents and not whether gain or loss may arise out of transactions in capital stock as the case is treated in the majority opinion. (Italics supplied.)*

It will be noted that the Court adopted the view of those dissenters. That view was that the transaction was not one comparable to that in which a corporation acquires and reissues its stock for cash, and that the regulation and decisions applicable to such a transaction were not applicable in the *Woods case*.

Thus the *Woods decision* carries within itself the distinction between that transaction and the instant one. That decision is not authority for the petitioner's contentions herein.

Petitioner cites *Com'r v. Boca Ceiga Dev. Co., supra*, (Bf. 29). That case offers no support for petitioner's contention herein. There taxpayer sold a tract of land at a profit. The purchaser delivered shares of seller's stock as the initial payment, repre-

senting about 9% of the purchase price. The Commissioner contended that the profit, realized on the sale of land, was taxable regardless of the fact that the respondent's stock was the medium by which a part of the payment was made. It will be noted that the Commissioner was not contending that a profit was made on a transaction or deal in stock, but that the taxable profit inhered in the sale of the land. The Court took the latter view and observed that since the profit was realized on a sale of land, it was taxable regardless of the medium in which payment was made.

The Court *did not decide*, as suggested by petitioner, that a corporation's own stock was property under the circumstances. A study of that case discloses that it is not even suggested.

Petitioner cites *Dorsey Co. v. Com'r*,<sup>1</sup> *supra*, (Bf. 30). The decision in that case negatives the argument based upon it by petitioner. There taxpayer sold a building at a profit. A part of the consideration consisted of shares of the seller's stock. In holding the profit on the sale to be taxable, the Court said:

It may well be that a corporation taking its cash and buying its own stock makes neither gain nor loss by the mere purchase. That is true of any purchase for cash. But when in a business exchange for its real estate it receives in part its own stock it is converting by sale a previous purchase, and if what it receives has a fair market value the gain or loss realized in the exchange must be measured and taxed. *It is not the purchase of the stock but the sale of the real estate that is regarded.* Such is the requirement of the statute. (Italics supplied.)

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It should be pointed out in passing that the amount of the gain held to be taxable in the *Dorsey* and *Allyn-Zerk* cases was within the amount of cash actually received by the corporation. We think these cases are more properly explained on the ground that the distribution from the corporation to its stockholder in respect of the stock surrendered was a capital transaction not giving rise to taxable gain and that the gain has reference to the sale of the remaining property to the stockholder for cash. An analogy is afforded in the "boot" provision of Section 112 providing for non-recognition of gain. Where property, other than that in respect of which no gain or loss is recognized, is received by the transferor, the amount of gain taxable is not in excess of the "boot" received.

It is important to note that the Fifth Circuit in the *Dorsey* case saw no reason to comment upon its earlier decision denying taxability to a naked transaction by a corporation in its own stock for cash. *Johnson v. Commissioner*, 56 F. (2d) 58. That case involved the following facts: In February, 1921, the corporate taxpayer repurchased 2,590 shares out of a total of its 7,500 shares outstanding, and paid therefor \$104,000 in cash. In October, 1921, it sold all its tangible assets (excluding, of course, the treasury stock), for an amount in excess of their cost and went out of business. After the sale the stockholders took corporate action to liquidate and dissolve, and a trustee in liquidation was appointed. The sale was upon deferred payments, and the profit thereon was taxable in 1921 and 1922. The Commissioner brought transferee proceedings against stockholders, who asserted two grounds for there being no profit on the sale. The first was that the amount paid to repurchase its own stock went to increase the cost of the real assets of the corporation. Obviously, this was untenable. The second contention was that the amount paid to repurchase stock was a loss in 1921 when the repurchase was made, or in 1922 (7th assignment of error, R. 44). The petitioner's contention was stated in his petition for review (p. 19) as follows:

But when the corporation disposes of its assets and goes out of business the value of the capital item is gone and it has been held that in that year the amount so expended constitutes a deductible loss.

The *Commissioner* argued that the amount paid in purchase of the treasury stock was a distribution to stockholders in a capital transaction, and said at page 19, ff., of his brief:

The statutes, however, make no provision for recognizing gain or loss on such *stock* transactions for the reason, of course, that they affect the capital structure of a corporation while those of bonds do not. Moreover, the interpretive regulations have consistently so held, and since successive taxing statutes have made no change therein, legislative approval is imported. \* \* \*

The statutes make no provision for deduction of premiums paid by a corporation in the acquisition of its own stock, and the Commissioner's regulations provide that "a corporation sustains no deductible loss from the sale of its capital stock" (see Art. 563, Regs. 45, 62, 65, and 69; Art. 66, Reg. 74), and, conversely, "A corporation realizes no gain or loss from the purchase of its own stock," as in the instant case (Reg. 62, Art. 543, *supra*; see also Art. 543, Regs. 45, 65, and 69; Art. 66, Reg. 74). It is submitted that, as this Court aptly stated in connection with a regulation in *Taylor Oil & Gas Co. v. Commissioner* (C. C. A. 5th, 47 F. (2d) 108, 109. "This is a reasonable regulation, and should be given effect. *Universal Battery Co. v. U. S.*, 281 U. S. 580." It is settled that administrative construction is not to be overruled unless plainly wrong. *Universal Battery Co. v. United States*, 281 U. S. 580, 583; *Fawcus Machine Co. v. United States*, 282 U. S. 374, 378. The later Revenue Acts have been similarly construed by the Commissioner and the failure of Congress to enact legislation disapproving the administrative construction imparts legislative approval thereof. *Brewster v. Gage*, 280 U. S. 327, 337; *Poe v. Seaborn*, 282 U. S. 101, 117; *McCaughn v. Hershey Chocolate Co.*, 283 U. S. 488, 492.

It is obvious that the purchase of Davis' stock affected only the capital structure of the Oil Company, and that it had no relation to the operation of the business or to the company's current income. Just as a sale of capital stock increases the amount of capital available for business purposes, so, conversely the purchase of treasury stock reduces that working capital, and diminishes the sum available for distribution to other stockholders. Whether it was advisable for the stockholders, in the present case, to accept a diminution in their equitable interests in order to eliminate a dissentious stockholder, was entirely a matter of their own concern in which the government is not interested. It did not affect the income of the company which, under section 2 (2) of the Revenue Act of 1921, *supra*, was regarded as a business entity, separate and distinct from its stockholders.

While an accession of income or sustenance of a loss may be realized upon the purchase by a corporation of its own bonds according to whether acquired below or above

the original price of issue (*United States v. Kirby Lumber Co., supra*), it is nevertheless equally clear that, under the law and regulations, no loss or gain can be realized by a corporation from the purchase of its own stock. The former does not involve the capital structure while the latter does.

The Court, in holding for the Government on both issues, said, at page 59:

Argument is unnecessary to demonstrate that what was paid to Davis for his stock added nothing to the actual cost of the assets. The Treasury Department has always ruled that a corporation receives no gain or loss from the purchase of its own stock. See article 543, T. R. 62 (1921). This is a reasonable and logical ruling and may be considered to have congressional approval by the enactment of subsequent revenue laws without any attempt to change it. The Board of Tax Appeals has consistently followed this ruling, holding such purchases to be capital transactions, amounting to a distribution of the stockholders' share of the assets.

Petitioner cites *Allyne-Zerk Co. v. Com'r*, 83 F. (2d) 525. There taxpayer sold all of its property assets and by agreement received some of its shares as payment medium. The profit on the sale was admitted. The Board said: "It was an ordinary sale of property for cash and other considerations, among them, the surrender for cancellation of a block of petitioner's stock." The profit was held taxable. The Court based its decision squarely on the point that property had been sold at a profit under sec. 202 (c) of the 1924 Act, and that such a profit was taxable, and that such profit can not be disregarded even though stock constituted a part of the consideration. The Court observed that the question is a close one but that the profit must be viewed as realized on the sale of its properties, and that what the taxpayer did with the proceeds of the sale has no bearing on the question as to whether the profit was realized.

The Court did not hold the profit to have been made in a

deal in stock. The decision does not support petitioner's argument herein.

The distinction between the cases cited by petitioner and the instant case is clearly set forth in the opinion in the *Squibb case* (*infra*, Appendix B, p. 70).

*The Principle Here Involved is Fundamental and Does Not Depend on Book Entries.*

Petitioner (Bf. 32-38) argues that corporations should not purchase their own shares without retiring them. He admits that generally the laws permit this to be done, but argues that accounting practice should be more uniform in the matter of recording such transactions. He argues that bookkeeping entries do not control in the question of whether or not an item is income.

Respondent has never claimed that the method of recording the instant transaction is controlling, but has insisted throughout that fundamentally such transactions are not productive of income, regardless of bookkeeping entries, and that they were so understood and considered when the 1928 Act was enacted, and had been so understood for many years prior thereto and were so understood for many years thereafter.

Petitioner's argument merely tends to raise a doubt where none apparently existed before, and further tends to support the application of the rule that where doubts exist they must be resolved in light of the long continued administrative, legislative and judicial interpretation of the Act.

*The Changed Regulations Do Not Control the Instant Transaction.*

At page 39 of his brief petitioner states that the changed regulation, in terms, treats the transaction here in question as giving rise to taxable income. He states: "It is not open to question that this regulation applies in terms to facts such as those here involved, and in terms governs pending proceedings involving the year here in question. The Board and the Court

below so understood, and respondent presumably does not take issue on this point."

All of the foregoing the respondent emphatically denies. Both in the Board and in the Court the respondent argued to the contrary. To the respondent it seems apparent that the very terms of the changed regulation preclude it from application to the instant facts.

The changed regulation does not purport to lay down a general rule that gain on sale of treasury stock is always subject to tax, irrespective of the circumstances surrounding the sale. Had the intention been to reach every sale of treasury stock, it could have been expressed in so many words. Whether the gain is subject to tax "depends upon the real nature of the transaction," which is to be determined from all the facts and circumstances. Obviously, the first sentence of the changed regulation limits the breadth of the Regulation but does not specify the instances for its application.

The instances giving rise to gain are specified in the remainder of the Article. The second sentence relates to original issue of stock. The fourth sentence relates to the receipt by a corporation of its own stock, (1) as consideration upon the sale of property by it, and (2) in satisfaction of indebtedness to it. The remaining specification is that when a corporation deals in its own shares as it might in the shares of another corporation, the gain, if any, is to be computed in the same manner as though the corporation were dealing in the shares of another. Synthesizing, the Article's limitation and its only possible application to sale of treasury stock would read as follows: All the facts and circumstances must lead to the conclusion that the corporation is dealing in its own shares as it might in the shares of another corporation before it can be said that the real nature of the transaction is such as to give rise to taxable gain.

In so far as the amendment to Article 66 has its origin in court decisions, rather than in zeal to raise revenue, its source may be found in the opinion in the *Woods case*, in which, it will be recalled, the Woods Company arranged for payment of a

debt to it in the form of a certain number of its own shares. The Court commented:

Whether the acquisition or sale by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction involved.

The facts of the case, and the tenor of the Court's opinion taken as a whole, make it plain that what the Court had in mind was that the transaction was in substance and effect not really a dealing in the corporation's own stock at all, except as the merest incident to a peculiarly income-producing corporate transaction.

The Commissioner, in recasting Article 66 of Regulation 74, followed the First Circuit opinion. The opinion said:

But where \* \* \* a corporation has legally dealt in its own stock as it might in the shares of another corporation, and in so doing has made a gain or suffered a loss, we perceive no sufficient reason why the gain or loss should not be taken into account in computing the taxable income.

With close attention to this opinion, the Commissioner promulgated his amended Regulation:

But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another.

Thus, the genesis of the new regulation is found in the *Woods case*<sup>1</sup> and, as we have shown above, in that case the distinction was clearly made (by the Board dissenters) that a transaction such as the instant one was not taxable, while the transaction in the *Woods case* was taxable. The Court adopted generally the language of those dissenters, and in no place indicated that

<sup>1</sup>See Petitioner's Brief, p. 49.

its opinion was intended to reach a transaction such as the instant case. The Court never indicated that an acquisition and a reissue of corporate stock for cash was a taxable transaction, or that such a transaction constituted dealing in shares of its own stock as it might in the shares of another corporation.

The other cases cited by petitioner are all to the same effect. None of them supports petitioner's statement.

Petitioner's statement that it is not open to question that this changed regulation applies in terms to the instant transaction, is refuted by the argument employed by Judge L. Hand in the *Squibb* case, *supra*, who said:

We share the taxpayer's doubts as to whether it dealt "in its own shares as it might in the shares of another corporation."

Petitioner's unsupported statement is further shown to be without foundation by the many Rulings and Decisions of the Department, by the many text writers, by the Courts and by the Board. It is axiomatic that if one corporation owns *shares of another corporation*, those shares constitute a *property asset* in its hands. The authorities have held for years that treasury stock is not a property asset in the hands of the issuing corporation. It follows, therefore, that to say a corporation can deal in its own shares "as it might in the shares of another corporation," is to utter a paradox; and, when the instant taxpayer issued its own shares for cash, it was not selling property. Since it was not selling property, the transaction does not fall within any of the decisions cited by petitioner, and since the changed regulation is obviously written to reflect those decisions the transaction does not fall within the changed regulations. The changed regulations do not in terms apply to the instant transaction.

*The Power of the Commissioner is Not Unlimited in the Matter of Making and Changing Regulations.*

Petitioner argues (Bf. 40 *et seq.*) that the power of the Commissioner to amend regulations is practically unlimited. Obviously that is not true. The Commissioner can not enact a law or change a law. If an interpretation of a statute has by Congressional approval come to have the force and effect of law, then clearly the Commissioner can not change it by a revised regulation. To permit him to do that would be a delegation of legislative powers. The Commissioner can interpret the law, he can not change the law.

The Commissioner's views as to his own powers is more clearly expressed by him at pages 45-47 of his brief. It appears that his view is that his power to make regulations and amend them is essentially a judicial function, and that in the exercise of his judicial function he may exercise his power to amend a regulation regardless of the legislative approval given to such regulation. He seems to argue that his power in this respect is analogous to that of this Court where this Court has modified or overruled precedents involving constitutional questions under the laws (Bf. mid. 46).

We do not understand the power of the Commissioner to be so extensive. This Court has denied, even to itself, the right to overturn a regulation which by long continued application and legislative sanction has come to have the force of law. We do not understand that this Court has ever conceded a judicial power to the Commissioner in excess of the power which it may itself exercise.

In *Walker v. United States*, 83 F. (2d) 103, the Court said:

The determination of the construction of the meaning of congressional acts is a judicial function. This function and duty is so entirely and purely judicial that it is beyond the power either of the executive<sup>1</sup> [citing cases] or of the Congress [citing cases] to control.

<sup>1</sup> The Commissioner is an official in the executive branch, and not in the judicial branch, of the Government.

The almost limitless powers claimed for the Commissioner, in his brief, would in effect comprise both legislative and judicial functions.

Petitioner further argues that the long continued construction and repeated reenactments of the statute in light of former regulations, is set at naught by the fact that the general definition of income has been inserted in revenue acts since the regulation was changed.

The answer to this argument is apparent:

*First*, the changed regulation is but a paraphrase of the decisions in the *Woods case* and similar cases.<sup>1</sup> The decisions in those cases are not now being questioned. Those decisions did not relate to transactions like the instant one. To the extent, therefore, that the new regulation reflects those decisions, the reenactment by Congress of sec. 22 (a) is a mere recognition of the apparent fact that sec. 22 (a) applies to transactions of the character obtaining in those cases. Since those cases do not purport to change the long continued construction applicable to the instant transaction, the reenactment of the last two revenue acts does not tend to overthrow Art. 66 of Reg. 74 which governs the instant transaction.

*Second*, if the reenactment of the section be deemed to overthrow a construction which, by long application and legislative approval, had come to have the force of law, then it follows that Congress meant to change the law (and not the regulation) and such a change in the basic law would be held only to have prospective application, in the absence of specific provision to the contrary.

*Third*, the regulation applicable to this case has received approval by the Board and the Courts in many decided cases, over a long period of time. The new regulation has received no such judicial approval. On the contrary two Circuit Courts of Appeals have said that it does not rule the instant transaction. (The *Squibb case*, *supra*, and the instant *Reynolds Tobacco Co. case*.) A third court (in the *First Chold case*) made no reference to the long continued regulations.

<sup>1</sup> The petitioner does not deny this. See p. 40 of Petitioner's Brief.

Fourth, the petitioner's statement (Bf. mid. 43) that in no case "in which this Court applied the rule of reenactment did the Court do so to prevent the application of a subsequently amended Regulation," is completely negatived by the decisions of this Court in *Hartley v. Com'r*, 295 U. S. 216; *McFeely v. Com'r*, 296 U. S. 102; *Koshland v. Helvering*, 298 U. S. 441; *Helvering v. Winmill*, — U. S. — (Cf. *Ibid* 93 F. (2d) 494); and by the Eighth Circuit in *Walker v. United States*, 83 F. (2d) 103.<sup>1</sup>

Petitioner (Bf. bot. 46, mid. 47) returns to the subject of the Commissioner's powers and argues that no amount of Congressional reenactment, and no amount of Congressional sanction of a given construction, can serve to limit the power of the Commissioner to extend, contract, alter or modify legislative intendment. His argument is that to question the right of the Commissioner to change his mind (after his former regulations and decisions have been for years upheld by the Department, the Board, and the Courts) is to challenge the propriety of the exercise by the Commissioner of the discretion vested in him; and that, as in the case of *judicial* modification of a statute, only an act of Congress can override the Commissioner's altered interpretation of the law.

Such a position on his part, if sustained, would effectually remove from the courts all tax controversies between the taxpayer and the Government, and delegate the interpretation as well as the administration of the taxing statutes to administrative bureaus. The argument contained in petitioner's brief would seem to justify the belief that such a delegation would not be unwelcome to him.

<sup>1</sup> A fifth answer may be found in *Helvering v. Tex-Penn Oil Co.*, 83 F. (2d) 518, affirmed 300 U. S. 481. In that case the Court observed that by the shifting of his position after his determination of a deficiency, the Commissioner lost whatever presumptions might be attributed to his position as the officer charged with making determinations. In the instant case the Commissioner made no determination that the instant transaction was taxable. Three years after the case was at issue, and after the point at issue in the Board had been agreed for settlement by the parties, and after the statute of limitations had expired (save for the proceeding in the Board), the Commissioner made his present contention and changed the regulation.

However, until such complete delegation is recognized the "construction of the meaning of congressional acts" is a function and duty which is purely judicial and is beyond the power of the executive. *Walker v. United States, supra*, p. 63.

*The Instant Case Does Not Involve an Exemption from Tax.*

In the last sentence of his brief petitioner suggests that the instant case presents an exemption from taxation. At the outset of the instant brief (and in Respondent's Brief in Opposition) it has been pointed out that this case presents no question of exemption. The Regulations, Rulings and Decisions for years have held that "if a corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation." Regs. 45, 62, 65, 69, 74, 77; L. O. 296, L. O. 426, L. O. 1035, L. O. 1035 (Rev.); A. R. R. 693, A. R. R. 799; I. T. 1802; and Board and court cases; all *supra*.

### CONCLUSION.

The Court below rendered its decision in light of the legislative, administrative and judicial construction of the Act, which construction received the approval of Congress in repeated reenactments of carefully considered revenue acts. The Court gave due consideration to all the pertinent factors, and followed the clear mandate of this Court in rendering its decision. The judgment of the Court below was correct and just. It should be affirmed.

Respectfully submitted,

J. GILMER KÖRNER, JR.,  
Attorney for Respondent,  
404 Transportation Building,  
Washington, D. C.

DAVID H. BLAIR,  
M. A. BRASWELL,  
Of Counsel.  
December, 1938.

## APPENDIX A.

## STATUTE AND OTHER AUTHORITIES INVOLVED.

Revenue Act of 1928, C. 852, 45 Stat. 791:

## SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

This provision was enacted in substantially the same language in the Revenue Act of 1913 and was thereafter so reenacted in the Revenue Acts of 1916, 1917, 1918, 1921, 1924, 1926 and 1928. The Revenue Act of 1928 is the controlling act in the instant case. Thereafter it was likewise so reenacted in the Revenue Acts of 1932 and 1934.

Treasury Regulations 74, relating to the Revenue Act of 1928:

ART. 66. *Sale by corporation of its capital stock.*—The proceeds from the original sale by a corporation of its shares of capital stock, whether such proceeds are in excess of or less than the par value of the stock issued, constitute the capital of the company. If the stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount is not a loss deductible from gross income. If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the shareholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation.

A corporation realizes no gain or loss from the purchase or sale of its own stock. (See article 176.)

The foregoing article is contained in practically identical language in Reg. 45 (1918 Act), Reg. 62 (1921 Act), Reg. 65 (1924 Act), Reg. 69 (1926 Act), Reg. 74 (1928 Act), and Reg. 77 (1932 Act).

Treasury Decision 4430, approved May 2, 1934, XIII-1 Cumulative Bulletin 36:

ARTICLE 66: Sale by corporation  
of its capital stock.

XIII-20-6792  
T. D. 4430

(Also Section 23 (i), Article 176.)

#### INCOME TAX.

Acquisition or disposition by a corporation of its own capital stock.

Articles 543 and 563, Regulations 65 and 69, and articles 66 and 176, Regulations 74 and 77, amended.

TREASURY DEPARTMENT,  
OFFICE OF COMMISSIONER  
OF INTERNAL REVENUE,  
Washington, D. C.

*To Collectors of Internal Revenue and Others Concerned:*

Articles 543 of Regulations 65, approved October 6, 1924, and Regulations 69, approved August 28, 1926, and articles 66 of Regulations 74, approved February 15, 1929, and Regulations 77, approved February 10, 1933, are hereby amended to read as follows:

*Acquisition or disposition by a corporation of its own capital stock.*—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable

gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of applicable statutes.

Article 563 of Regulations 65, approved October 6, 1924, and Regulations 69, approved August 28, 1926, are hereby amended by striking out the first and second sentences thereof, by substituting the words "a corporation" in place of the second word in the third sentences of those articles, and by adding the following sentence to those articles:

"As to the acquisition or disposition by a corporation of its own capital stock, see article 543."

Article 176 of Regulations 74, approved February 15, 1929, is hereby amended by omitting the first and second sentences thereof, by substituting the words "a corporation" in place of the second word in the third sentence of this article, and by adding the following sentence to this article:

"As to the acquisition or disposition by a corporation of its own capital stock, see article 66."

Article 176 of Regulations 77, approved February 10, 1933, is hereby amended by omitting the first and second sentences thereof, and by adding the following sentence to this article:

"As to the acquisition or disposition by a corporation of its own capital stock, see article 66."

GUY T. HELVERING,  
*Commissioner of Internal Revenue.*

Approved May 2, 1934.

H. MORGENTHAU, JR.,  
*Secretary of the Treasury.*

## APPENDIX B.

Opinion of the Second Circuit Court of Appeals in *E. R. Squibb & Sons v. Helvering*, 97 F. (2d) 69 (see pp. 42-43, *supra*).

L. HAND, Circuit Judge.

This appeal is from an order, assessing a deficiency on the taxpayer's income tax return for the year 1932. The taxpayer is a large manufacturer of drugs and other chemicals, which in the year 1929 devised a plan to allow its customers to share in its profits. They were to take stock in a corporation organized by the taxpayer under the name of Squibb Plan, Inc., whose assets were to consist of shares of stock of the taxpayer, bought by it and sold to Squibb Plan, Inc., at \$50 a share—a price below its market value at the time, but higher than in 1932. The taxpayer, as required by its contract, continued to buy its shares as they fell, and in 1932, sold a number of them to Squibb Plan, Inc. Because of the fall it realized a substantial profit, which the Commissioner included in its income for that year and on which he calculated a deficiency. The taxpayer appealed to the Board and then to this court from the Board's affirmance.

The definition of gross income—§22 of the Revenue Act of 1932, 26 U.S.C.A. §22—is in too general terms to throw any light upon the question at bar; but from 1918 to 1932 the regulations of the Treasury provided that the proceeds of the original sale of capital shares—whether more or less than par value—were capital; that purchases by the corporation of its own shares would be considered capital transactions; and that no resulting gain should be income: "the corporation realizes no gain or loss from purchase or sale of its own stock." This remained through five recensions of the tax laws—1921, 1924, 1926, 1928 and 1932—but on May 2, 1934, it was changed to the form shown in the margin.<sup>1</sup> The taxpayer insists that the amend-

<sup>1</sup> "Acquisition or disposition by a corporation of its own capital stock.—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

"But where a corporation deals in its own shares as it might in the shares of

ment does not by its words cover the transaction in question; and that if it did, it would be unlawful, because the earlier regulation had received an authoritative interpretation through the long acquiescence of Congress, just noted. *Brewster v. Gage*, 280 U. S. 327, 336, 337, 50 S. Ct. 115, 117, 74 L. Ed. 457; *Poe v. Seaborn*, 282 U. S. 101, 51 S. Ct. 58, 75 L. Ed. 239; *McCaughn v. Hershey Chocolate Co.*, 283 U. S. 488, 51 S. Ct. 510, 75 L. Ed. 1183; *Koshland v. Helvering*, 298 U. S. 441, 56 S. Ct. 767, 80 L. Ed. 1268, 105 A. L. R. 756; *McFeely v. Commissioner*, 296 U. S. 102, 56 S. Ct. 54, 80 L. Ed. 83, 101 A. L. R. 304; *United States v. Farrar*, 281 U. S. 624, 50 S. Ct. 425, 74 L. Ed. 1078, 68 A. L. R. 892.

We share the taxpayer's doubts whether it dealt "in its own shares as it might in the shares of another corporation," within the very equivocal language of the regulation. It is at least arguable that this means to cover only speculations of a corporation, and not a profit-sharing enterprise like that at bar. But in any event it seems to us that the uniform interpretation, so long placed upon §22 (a) 26 U. S. C. A. §22 (a), by the regulation and confirmed by the inaction of Congress, was imbedded in the statute so deep that only legislation could dislodge it. We need not say that no other interpretation could have been made: it is not uncommon, when a corporation buys its own shares, to regard them as still existing in a kind of limbo, so that when it sells them again, it does not reissue them *de novo*, but sells its own property. That convention may be sufficient constitutional basis for a statute which should tax as income the difference between the amount paid to buy in "treasury shares" and that received on their sale; we do not mean to suggest the opposite, for in such matters convention may be conclusive. Nevertheless it is very difficult—indeed to us it seems impossible—to understand how the notion of a gain to the corporation from such transactions is legally tenable, except when the sale of the shares is at a price higher than their real value at the time of the sale. Such a belief must depend

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another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also, if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of applicable statutes."

upon the mistaken supposition that after purchase the shares have an existence as such, and are more than a mere power to issue shares, like authorized, but unissued, shares. This seems to us unsound. *Borg v. International Silver Company*, 2 Cir., 11 F. 2d 147.

If one regards the corporation as the group of its shareholders collectively, that is very apparent. If they sell "treasury shares," bought at a lower price, what really happens is that the group has been enlarged; new shareholders have been added. Always assuming that the shares are sold at their true value, the old group has not profited because the sale of the "treasury shares" leaves the value of their own shares absolutely untouched. The purchase price received for each "treasury share" sold will by hypothesis exactly match the value of each old share, and the sold share will neither trench upon, nor leave any margin of profit for, the old shares. All that has happened is that a larger group is doing business with a proportionally increased capital. The same is true also, if the corporation be regarded as a juristic person, *stricti juris*. Before the sale of "treasury shares" the corporation is liable to its shareholders in the sum of their claims against it, which equal the net value of its then assets, including any increase in their value during the period when the "treasury shares" have been held. The corporate assets are of course increased by the sale, but the new shares create new liabilities which will precisely equal the increase, and there can be no profit to the corporation. The only escape from this is to treat the corporation as so completely independent of its shareholders, that its obligations to them should be disregarded in figuring its gains or losses. But to do that would completely distort the corporate income, and charge it as profit with all that it receives when it sells "treasury shares," and to credit it as loss with all that it pays to purchase them. Indeed, the whole reasoning which supports the emergence of profit from such transactions presupposes that the corporation has relieved itself of an obligation when it buys a share and creates one when it sells one. Since on analysis this appears to be legally untenable, it is plain that the original interpretation of the Treasury was at least permissible. We agree rather with *J. R. Reynolds v. Com'r*, 4 Cir., 97 F. 2d 302, than with *First Chrold Corp. v. Com'r*, 3 Cir. 97 F. 2d 22.

We must not be misled by those cases in which the corporation is held to have realized a gain in property sold to its shareholders for its own shares. *Dorsey Co. v. Com'r*, 5 Cir.,

76 F. 2d 339; *Allyne-Zerk Co. v. Com'r*, 6 Cir. 83 F. 2d 525. The question there is whether the cost of the property is less than what the corporation receives for it. The purchase price is measured by the extent by which the remaining shareholders profit by the retirement of the shares of the buyers; and is the full value of their shares at the time of the transaction. So too, when, as in *Com'r v. S. A. Woods Machine Co.*, 1 Cir., 57 F. 2d 635, the corporation takes over and retires outstanding shares in settlement of a claim whose cash payment would have been wholly income. In both situations the remaining shareholders are enriched by the full present value of the shares; and this is part income, or all income, according as the consideration given in exchange had or had not any "basis."

In the foregoing we have excluded the possibility that at the time of sale to Squibb Plan, Inc. the shares had a value of less than \$50. In fact they may have had, and if so, the question would necessarily arise whether there was a profit in this difference, and whether the former regulation forbade its taxation, or only covered differences between the prices at which shares might be bought in and later sold. My brothers believe that we should now decide both questions; they think that such a difference is taxable income and that the regulation did not forbid its taxation. I am not prepared to dissent, but the point has not been argued, and, had I been alone, I should have referred it back to the Board along with the determination of the value of the shares at the time of their sale. The order will be reversed, and the cause remanded to the Board, to assess any deficiency based upon differences between the sale price, \$50, and the value of the shares at the time of sale.

Order reversed; cause remanded.

## APPENDIX C.

Report of the Committee on Accounting Procedure to the Executive Committee of the American Institute of Accountants, reprinted from The Journal of Accountancy, Official Organ of the American Institute of Accountants, Vol. 65, No. 5, pp. 417-418, May, 1938:

This committee has had under consideration the question regarding treatment of purchase and sale by a corporation of its own stock which was raised during 1937 by the New York Stock Exchange with the Institute's special committee on cooperation with stock exchanges.

As a result of discussions which then took place, the special committee on cooperation with stock exchanges made a report which was approved by the committee on accounting procedure and the executive committee, and a copy of which was furnished to the committee on stock list of the New York Stock Exchange. The question raised was stated in the following form:

"Should the difference between the purchase and resale prices of a corporation's own common stock be reflected in earned surplus (either directly or through inclusion in the income account) or should such difference be reflected in capital surplus?"

The opinion of the special committee on cooperation with stock exchanges reads in part as follows:

"Apparently there is general agreement that the difference between the purchase price and the stated value of a corporation's common stock purchased and retired should be reflected in capital surplus. Your committee believes that while the net asset value of the shares of common stock outstanding in the hands of the public may be increased or decreased by such purchase and retirement, such transactions relate to the capital of the corporation and do not give rise to corporate profits or losses. Your committee can see no essential difference between (a) the purchase and retirement of a corporation's own common stock and the subsequent issue of common shares, and (b) the purchase and resale of its own common stock."

This committee is in agreement with the views thus expressed;

it is aware that such transactions have been held to give rise to taxable income, but it does not feel that such decisions constitute any bar to the application of correct accounting procedure as above outlined.

The special committee on cooperation with stock exchanges continued and concluded its report with the following statement:

"Accordingly, although your committee recognizes that there may be cases where the transactions involved are so inconsequential as to be immaterial, it does not believe that, as a broad general principle, such transactions should be reflected in earned surplus (either directly or through inclusion in the income account)."

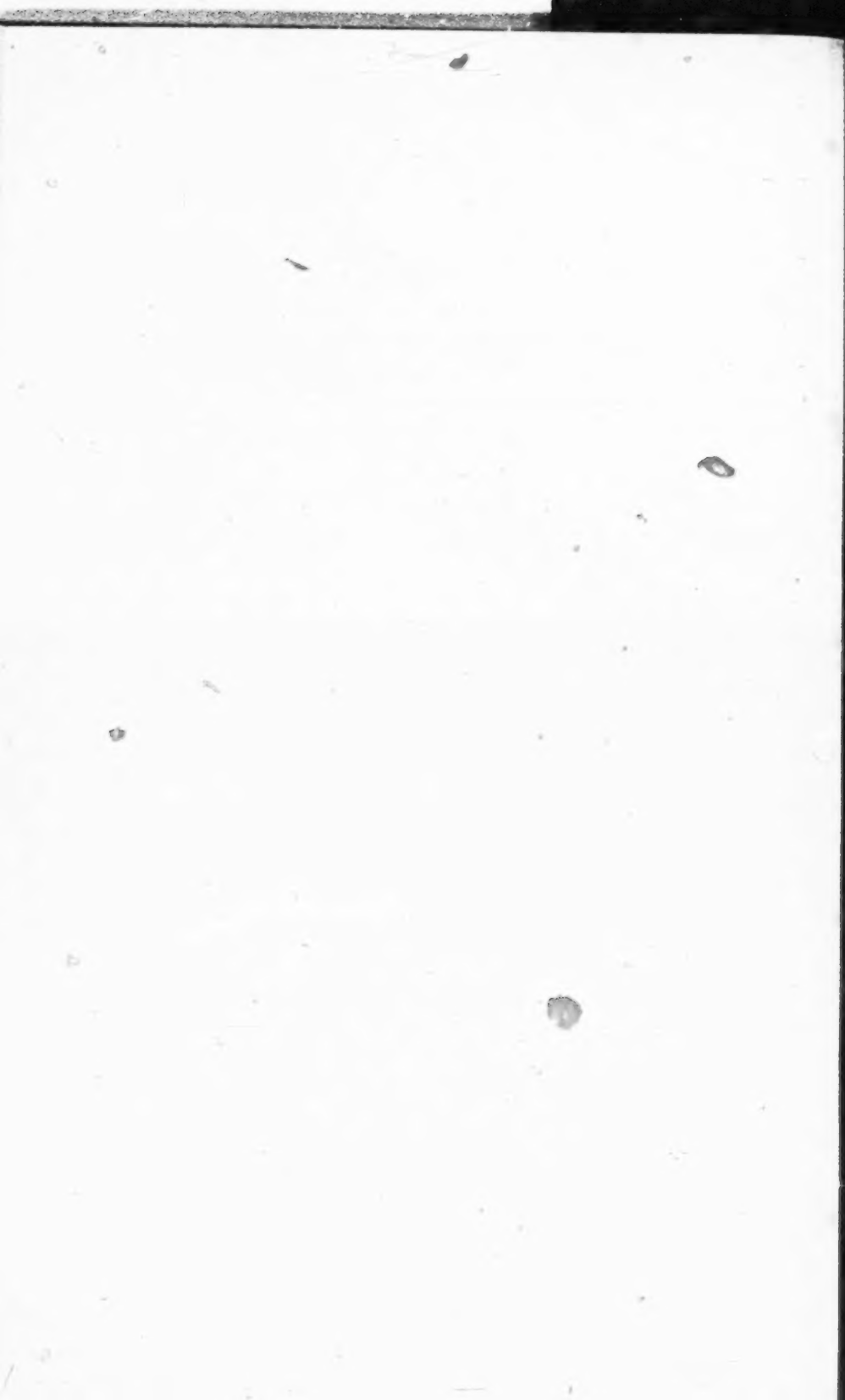
This committee agrees with the special committee on cooperation with stock exchanges, but thinks it desirable to point out that the qualification should not be applied to any transaction which, although in itself inconsiderable in amount, is a part of a series of transactions which in the aggregate are of substantial importance.

This committee recommends that the views expressed be circulated for the information of members of the Institute.

Respectfully submitted,

COMMITTEE ON ACCOUNTING  
PROCEDURE,

George O. May, *Chairman*,  
Samuel J. Broad,  
Arthur H. Carter,  
A. S. Fedde,  
Henry A. Horne,  
Frederick H. Hurdman,  
Roy B. Kester,  
Rodney F. Starkey.



# SUPREME COURT OF THE UNITED STATES.

No. 328.—OCTOBER TERM, 1938.

Guy T. Helvering, Commissioner  
of Internal Revenue,  
Petitioner,  
vs.  
R. J. Reynolds Tobacco Company.

On Writ of Certiorari to the  
United States Circuit Court  
of Appeals for the Fourth  
Circuit.

[January 30, 1939.]

Mr. Justice ROBERTS delivered the opinion of the Court.

The sole question for decision is whether gain accruing to a corporation consequent on the purchase and resale of its own shares constitutes gross income within the meaning of Section 22(a) of the Revenue Act of 1928.<sup>1</sup>

The respondent, a New Jersey corporation, on occasions between 1921 and 1929, purchased its own Class B common stock for reasons of policy, such as the elimination of a very large single holding, the broadening of the ownership of the stock, and the support of the market to protect the investments of employe shareholders. This stock was resold from time to time. While held it was treated as treasury stock and the cost of it was entered in the accounts as "Investments in Non-competitive Companies". The books showed no increase or reduction of capital stock on account of purchases or sales. During 1929 the company sold shares acquired in that and prior years for a sum which exceeded cost by \$286,581.21, which amount was entered in the books as a cash item and added to surplus. In its income tax return for 1929 the company listed this gain under the caption "Other Items of Non-Taxable Income", as "Profit R. J. R. Stock".

The Commissioner determined a deficiency in the tax paid for 1929 involving items not here in controversy and the company appealed to the Board of Tax Appeals where those items were adjusted. Before the case was closed the Commissioner by amended answer alleged that the taxpayer's net income should be increased by

<sup>1</sup> c. 952, 45 Stat. 791.

the amount of the "net profit realized . . . through trafficking in Class B common stock of the . . . Company", and claimed a resulting deficiency. He based his claim upon Treasury Regulation 74, Article 66, as amended by a Treasury decision of May 2, 1934,<sup>2</sup> which states "where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another."

The Board, after finding the facts in detail, sustained the Commissioner.<sup>3</sup> The Circuit Court of Appeals reversed the Board's ruling.<sup>4</sup> Because of asserted conflict we granted the writ of certiorari.<sup>5</sup>

Section 22(a) is: "General definition.—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever." Section 62 directs the Commissioner, "with the approval of the Secretary" of the Treasury, to "prescribe and publish all needful rules and regulations for the enforcement of this title." Article 66 of Treasury Regulations 74, promulgated under the Act of 1928, so far as material, is: "If . . . the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock."

Petitioner contends that, as Congress must be taken to have exercised its constitutional power to the fullest extent in laying the tax, Section 22(a) should be held to include the gain realized from sales of a corporation's own stock, and the quoted regulation can-

<sup>2</sup> Treasury decision 4430, XIII-1 Cumulative Bulletin 36.

<sup>3</sup> 35 B. T. A. 949.

<sup>4</sup> *R. J. Reynolds Tobacco Co. v. Commissioner of Internal Revenue*, 97 F. (2d) 302.

<sup>5</sup> See *First Chroid Corp. v. Commissioner*, 42/ps. p. —.

not restrict the scope of the statutory definition. The respondent replies that such gain is capital gain and not income, as is demonstrated by the theory and practice of accounting<sup>6</sup> and by court decisions.<sup>7</sup> The court below found it unnecessary to decide this issue, holding that whether the increment is income is at least a debatable question and the regulation was, therefore, proper as an interpretation of the meaning of the section. We agree that Section 22 is so general in its terms as to render an interpretative regulation appropriate.<sup>8</sup>

The administrative construction embodied in the regulation has, since at least 1920, been uniform with respect to each of the revenue acts from that of 1913 to that of 1932, as evidenced by Treasury rulings and regulations, and decisions of the Board of Tax Appeals.<sup>9</sup> In the meantime successive revenue acts have reenacted, without alteration, the definition of gross income as it stood in the Acts of 1913, 1916, and 1918.<sup>10</sup> Under the established rule Congress must be taken to have approved the administrative construction and thereby to have given it the force of law.

The petitioner contends that if nothing further appeared he would be bound to apply the statute in conformity to the regulation. He asserts, however, that the amendment adopted by the Treasury May 2, 1934, while this cause was pending before the

<sup>6</sup> See e. g. Dickinson, "Accounting Practice and Procedure", 130, 131; Selver and Pinkerton, "Corporation Accounting", 121; Straightoff, "Advanced Accounting", 184-5.

<sup>7</sup> Johnson v. Commissioner, 36 F. 2d 38; E. R. Squibb & Sons v. Helvering, 6 F. 2d 49; compare Berg v. International Silver Co., 11 F. 2d 143, 147; Commissioner v. Inland Finance Co., 63 F. 2d 346; Carter Hotel Co. v. Commissioner, 47 F. 2d 642.

<sup>8</sup> Matthews v. Commissioner, 296 U. S. 344, 354.

<sup>9</sup> See L. O. 1035, 2 C. B. 122, 3 C. B. 140; L. O. 226, 5 C. B. 215; L. O. 426, 10 C. B. 210; A. A. R. 693, 5 C. B. 297; L. T. 1194, C. B. 111, 215; A. A. R. 796, C. B. 111, 374; L. T. 1342, C. B. 112, 267; Reg. 45, Arts. 541 and 542; Reg. 41, Arts. 543 and 543; Reg. 45, Arts. 543 and 543; Reg. 49, Arts. 543 and 543; Reg. 54, Arts. 46 and 176; Reg. 57, Arts. 46 and 176; Simmons & Hammond Mfg. Co., 1 B. T. A. 88; Cooperative Furniture Co., 2 B. T. A. 167; Atlantic Carton Corp., 2 B. T. A. 380; Hutchins Lumber & Storage Co., 4 B. T. A. 28; Farmers' Deposit Nat. Bank, 5 B. T. A. 320; H. S. Crocker Co., 5 B. T. A. 33; Interurban Const. Co., 5 B. T. A. 329; Liberty Agency Co., 5 B. T. A. 77; Union Trust Co., 12 B. T. A. 448, 490; 105 West 55th Street, Inc., 13 B. T. A. 219, 213; American Cigar Co., 21 B. T. A. 464, 495; Carter Hotel Co., 15 B. T. A. 933.

<sup>10</sup> See R. A. 1913, § 11, B. 38 Stat. 167; R. A. 1916, § 2 a, 39 Stat. 757; R. A. 1918, § 213 a, 40 Stat. 1065; R. A. 1921, § 213 a, 42 Stat. 234; R. A. 1924, § 213 a, 43 Stat. 267; R. A. 1926, § 213 a, 44 Stat. 23; R. A. 1929, § 22 a, 45 Stat. 797; R. A. 1932, § 22 a, 47 Stat. 178.

Board, is controlling. By the amendment Article 66 is made to read: "Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances."

"But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. . . . Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of applicable statutes."

Petitioner urges that the amendment operates retroactively and governs the ascertainment of gross income for taxable periods prior to the date of its promulgation, and, further, since Congress has reenacted Section 22(a) in the Revenue Acts of 1936 and 1938, it has approved the regulation as amended. We hold that the respondent's tax liability for the year 1929 is to be determined in conformity to the regulation then in force.

Section 605 of the Revenue Act of 1928 provides that "In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect." It is clear from this provision that Congress intended to give to the Treasury power to correct misinterpretations, inaccuracies, or omissions in the regulations and thereby to affect cases in which the taxpayer's liability had not been finally determined, unless, in the judgment of the Treasury, some good reason required that such alterations operate only prospectively. The question is whether the granted power may be exercised in an instance where, by repeated reenactment of the statute, Congress has given its sanction to the existing regulation.

Since the legislative approval of existing regulations by reenactment of the statutory provision to which they appertain gives such regulations the force of law, we think that Congress did not intend

11 45 Stat. 874. Somewhat similar provisions were contained in earlier acts. See Revenue Act of 1921, Section 1314, 42 Stat. 314; Revenue Act of 1926, Section 1108(a), 44 Stat. 114.

to authorize the Treasury to repeal the rule of law that existed during the period for which the tax is imposed. We need not now determine whether, as has been suggested,<sup>12</sup> the alteration of the existing rule, even for the future, requires a legislative declaration or may be shown by reenactment of the statutory provision unaltered after a change in the applicable regulation. As the petitioner points out, Congress has, in the Revenue Acts of 1936 and 1938, retained Section 22 as of the 1928 Act *in haec verba*. From this it is argued that Congress has approved the amended regulation. It may be that by the passage of the Revenue Act of 1936 the Treasury was authorized thereafter to apply the regulation in its amended form. But we have no occasion to decide this question since we are of opinion that the reenactment of the section, without more, does not amount to sanction of retroactive enforcement of the amendment, in the teeth of the former regulation which received Congressional approval, by the passage of successive Revenue Acts including that of 1928.

The judgment is affirmed.

A true copy

Test :

*Clerk, Supreme Court, U. S.*

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<sup>12</sup> *Squibb & Sons v. Helvering*, 98 F. (2d) 69, 70.